Ref.: Voting on amendments to MiFID commodity derivatives rules to guarantee orderly food and energy pricing and protect the public interest (14 February 2023 discussions)

Amsterdam, 13 February 2023

Dear Member of ECON Committee at the European Parliament,

The current discussions to amend the Markets in Financial Instruments Directive (MiFID) by the European Parliament (ECON committee), comes at the right moment. The directive itself refers to the fact that position limits in commodity derivative markets should be reviewed 'where there is a significant change on the market, including a significant change in deliverable supply or open interest' (Art. 57.4 of MiFID). Clearly, the war in Ukraine, the sanctions against Russia, as well as (post-) COVID-19 supply chain disruptions have significantly changed the way the supply in agricultural and fossil fuel energy commodities is delivered. The record high prices for consumers and the 2022 record high profits by fossil fuel companies and agribusinesses[1] show that the market has significantly changed as well. The net positions of financial market participants in Euronext's wheat market have increased from 25% in June 2018 to 49% in June 2022, which is a significant change for the pricing dynamics.[2]

The high and volatile commodity price volatility in 2022 goes against MiFID's goal of 'orderly pricing' and preventing distorting positions (Art. 57). The market change due the COVID-19 pandemic has led to amendment in MiFID's commodity derivatives' regime in 2021. Current supply and market change also warrant to change the MiFID's commodity derivatives trade instruments in order to provide policy makers and financial authorities the right legal tools to deal with the new circumstances and changes in commodity derivatives markets to prevent undue high commodity prices continuing to seriously disrupt many businesses and the economy and prevent access to basic needs by a growing number of the population. Monetary policy has so far not been able to sufficiently reduce inflation amongst others because the extra-ordinary commodity price levels have not sufficiently been tackled. Volatility at commodity derivatives markets are a financial stability risk according to the ECB and other financial authorities.[3] The high profits by energy and food companies, resulting from commodity market prices being well above production prices, indicate distortions in the market-based commodity pricing mechanisms and disconnection from the needs of the economy and citizens, or even from actual available supplies or reserves.

The EC, ESMA and some national competent authorities[4] have argued at the European Parliament that the very high commodity prices were reflecting a correct way how the commodity derivatives market are working. Since this means that any presumed, real or rumoured scarcity of supply can lead to limitless high commodity prices, the EU decided it was necessary to impose a price cap, be it at a very high level in order not to disrupt supplies.

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1 See for instance: Archer Daniels Midland Net Income 2010-2022 | ADM, https://www.macrotrends.net/stocks/charts/ADM/archer-daniels-midland/net-income; Bunge Net Income 2010-2022 | BG, https://www.macrotrends.net/stocks/charts/BG/bunge/net-income .

2 Euronext, Agricultural commodity markets In Europe, Power point presented by N. Kennedy at the Agricultural Market Information System (AMIS) seminar, 20 October 2022, http://www.amis-outlook.org/fileadmin/user_upload/amis/docs/AMIS_thematic_webinars/Euronext_overview_presentation_-_Nicholas_Kennedy.pdf .

3 ECB, Financial Stability Review, November 2022, p. 95 onwards, https://www.ecb.europa.eu/pub/pdf/fsr/ecb.fsr202211~6383d08c21.en.pdf; see also warnings by the Financial Stability Board, https://www.fsb.org/2022/04/potential-risks-to-financial-stability-from-rising-commodity-prices/ ; C. Matthews, 'Commodity prices are going haywire, prompting fears of the next financial crisis', MarketWatch, 23 April 2022, https://www.marketwatch.com/story/commodity-prices-are-going-haywire-prompting-fears-of-the-next-financial-crisis-11650378691 : The IMF warned of 'severe pressures' in commodity markets in a financial stability report.

4 C. Hensen and D. Stokmans, 'Speculanten horen bij een goed functionerende markt', NRC, 3 November 2022, https://www.nrc.nl/nieuws/2022/11/03/speculanten-horen-bij-een-goed-functionerende-markt-a4147236 .

However, amendments to the current MiFID regime would be a better and complementary way to reduce undue price increases or volatility by ensuring less excessive financial speculative trading in the commodity derivatives markets. Changes could be made as follows:

(1) Amending position limits on non-hedging positions (Art. 57)

The EC, ESMA and some national competent authorities have stated that speculators are part of a well-functioning market as they provide liquidity in the commodity derivatives markets (smooth buying and selling by speculators taking some risks). Normal market functioning before the pandemic has shown that this means liquidity is more than sufficient when speculating financial firms hold 20% to 30% of the futures' open interest positions. However, research has exposed that immediately following the start of the war, financial speculators (investment firms, investment funds, commodity ETFs that combine different unrelated commodities[5], hedge funds, pension funds[6], high frequency traders, etc.) rushed into 'long' (buy side) wheat futures speculating on higher prices.[7] In March 2022, wheat export prices had already hit a 14-year peak, rising 20% above February prices.[8] In April 2022, investment firms and investment funds had increased their holdings in 'long' wheat futures on Euronext Paris MATIF's trading venue to 46% open interest as compared to venue from 5 % in 2018.[9] Analysis of the report of trading on Euronext Paris MATIF from 1 to 6 July 2022 shows that 68% of 'long' wheat contracts were held by financial parties and non-hedging commercial parties.[10] These are **excessive speculative positions** which have been driving up prices and increasing volatility according various recent research.[11] For instance, research by UNCTAD[12] indicates that the 'effect of the excessive speculation is overwhelming volatility in oil prices, often driving the price of a barrel of crude oil $25 to $30 above what market fundamentals dictate (Juhasz, 2022).' Moreover, prices went down once 'US monetary tightening resulted in money flowing into dollar assets and out of commodity derivatives'.[13] These price movements by speculative players require much stricter position limits on agricultural and energy derivatives (futures, OTC, options)

5 L. Hekman et al., The hunger profiteers, Lighthouse Reports, 6 May 2022, https://www.lighthousereports.nl/investigation/the-hunger-profiteers/ : For instance during the first week of March 2022, $ 4.5 billion dollars was invested in commodity-based Exchange Traded Funds (ETF's) - compared with only $ 197 million during the whole of 2021.; IPES-Food, Another perfect storm? How the failure to reform food systems has allowed the war in Ukraine to spark a third global food price crisis in 15 years, and what can be done to prevent the next one, May 2022, p. 11, https://ipes-food.org/_img/upload/files/AnotherPerfectStorm.pdf: The price of wheat on futures markets jumped 54% in just 9 days in March 2022, and then retreated nearly as quickly, albeit remaining at a high level.

6 Lighthouse Reports, How Europe's pension funds are gambling with food prices, EU Observer, 12 October 2022, https://euobserver.com/health-and-society/156260 : Research of pension funds in EU countries and the UK investing in commodity derivatives exposed that the Dutch pension funds ABP had invested € 33.9 bn in 2021 and the increase in commodities prices last year meant ABP's investments grew by €8bn despite net sales.

7 UNCTAD, Development prospects in a fractured world: Global disorder and regional responses, Trade and Development Report 2022, 2023, https://unctad.org/system/files/official-document/tdr2022_en.pdf

8 IPES-Food, Another perfect storm?, May 2022, p. 3.

9 UNCTAD, Trade and Development Report 2022, p. 67-68.

10 Euronext, Derivatives Weekly Position Reporting - Milling wheat, EURONEXT PARIS [MATIF], 7 July 2022, https://live.euronext.com/sites/default/files/commodities_reporting/2022/07/06/en/cdwpr_EBM_20220706.pdf .

11 L. Kornher, J. von Braun, and B. Algieri, Speculation risks in food commodity markets in the context of the 2022 price spikes - Implications for policy, ZEF Policy Brief Nr. 40, April 2022, p. 7, https://www.zef.de/fileadmin/user_upload/ZEF_Policy_Brief_40_eng-_27_4_2022.pdf: 'The pressure of speculative market activity is measured by the level of "non-commercial" positions relative to open interest or total "commercial" positions.[21] The share of long-position held by non- commercial traders is currently [April 2022] around 50%, which is like the speculative pressure index at the level in 2007/2008. Overall, the increasing share of speculators increases the risk that price formation could become decoupled from market fundamentals and more strongly influenced by financial market strategies.'; See also: P. Smith (Rapporteur), Food price crisis: the role of speculation and concrete proposals for action in the aftermath of the Ukraine war, EESC own initiative opinion, 1 December 2022, https://www.eesc.europa.eu/en/our-work/opinions-information-reports/opinions/food-price-crisis-role-speculation-and-concrete-proposals-action-aftermath-ukraine-war; L. Hekman et al., The hunger profiteers, Lighthouse Reports, 6 May 2022.

12 UNCTAD, Trade and Development Report 2022, p. 32 : also mentioning 'Likewise, speculative activity by hedge funds, investment banks and pension funds has driven up wheat prices (box 2.3; Kornher et al., 2022).'

13 UNCTAD, Trade and Development Report 2022, p. 65 – 66.

and effective supervisory mandates and capacity to prevent excessive speculation in commodity derivatives markets, as also recommended by UNCTAD.[14]

Amendments of Art. 57 to re-establish and recalibrate strict position limits for speculative market participants will allow to prevent excessive speculation that lead to undue high price hikes and volatility. Special attention to be paid to strictly limits on positions by very speculative players such as commodity ETFs whose bundling of commodities unduly automatically affect various commodity markets, high frequency traders and hedge funds.

(2) Require more detailed reporting for effective transparency and supervision (Art. 58)

The current reporting requirements do not provide sufficient information per commodity derivative contract to identify excessive speculation that drives up or swiftly changes prices, in contrast to financial participants contributing orderly pricing. In order for financial authorities and policy makers to be able to better intervene to avoid malfunctioning of the price setting through excessive speculation, the MiFID requirements for public reporting by trading venues should add to the current requirements:

- Reporting per day the trading volume per category of persons/market participants buying and selling on that day, and changes since the previous day. Such daily reports provide speedier evidence to financial authorities whether to instruct market participants to reduce their position or to initiate investigations to stop excessive speculation.
- Reporting on the average trading velocity, i.e. the period between each category of market participant opens and closes his position. High velocity would indicate undue speculative movements.
- Reporting on the ratio between the volume of the traded contracts volume and the total number of contracts that are physically delivered. Such information would allow to better identify whether or not the non-hedging positions are excessively influencing the pricing on the trading venues.

The current lack of information regarding available stocks, leaves agricultural and energy markets vulnerable to physical hoarding and financial speculation. The UN's Food and Agricultural Organisation (FAO), the World Bank and International Panel of Experts on Sustainable Food Systems (IPES-food) have indicated that there is no risk of a global lack of food. Globally there is a huge reserve of wheat – despite the invasion of Ukraine, which is an important producer.[15] However, most of the commodity stocks are private and unknown,[16] which makes it difficult to assess whether the commodity derivatives prices are correctly pricing and hedging risk, a main objective of MiFID. In order to provide more transparency of stocks in relation to commodity derivatives trading, commercial participants could be asked to report on their stocks of the underlying commodity.

More specified and comprehensive public reporting and better tools by ESMA to make such reports from all trading venues in the EU available in a better accessible way, would not only support financial authorities and policy makers to guarantee better pricing of basic commodities but also allow consumers, civil society and academics to assess whether the current commodity derivatives trading regime is fit to serve the public interest.

(3) Better and more transparent use of circuit breakers (Art. 48):

14 UNCTAD, Trade and Development Report 2022, p. 2.

15 Navdanya International, Sowing Hunger, Reaping Profits – A food crisis by design, July 2022, https://navdanyainternational.org/wp-content/uploads/2022/07/SOWING-HUNGER-REAPING-PROFITS-REPORT-d1.pdf?fbclid=IwAR3hv25QzQt2S8nGv95MaeiFExZchecD04qgBGhgXHjrXNujSpL1QYp8WKM

16 IPES-Food, Another perfect storm?, May 2022, p. 12 and 22.

Circuit breakers on and by trading venues are an intervention tool to temporarily halt or restrict trading for a short period when price volatility and excessive speculation exceeds established highest and lowest price limits. It is currently insufficiently transparent whether, when and how trading venues are using circuit breakers so as to avoid excessive speculation while frantic trading might increase the profits of the trading venues. ICE reportedly didn't use the circuit breaker despite all-times high volatility on the Dutch gas derivatives market (TTF). In order to improve use and transparency of circuit breakers by trading venues and ensure orderly pricing, amendments should:

- Require a trading venue to publicly disclose the when and based on what parameters a circuit breaker has halted trading;
- Require a trading venue to develop in a balanced way the technical parameters and in what circumstances a circuit breaker will be triggered and publicly report on these trigger criteria;
- Allow the competent national authorities to intervene in case the trading venues do not have properly developed circuit breaker criteria or do not use the circuit breakers to halt disorderly trading and excessive speculation

(4) Speculation by non-financial traders (non-distortive criteria for <u>'ancillary activity'</u>) (Art. 2 paragraph 1 and 4):

The current MiFID rules allow physical commodity traders to also engage in financial speculation when providing investment services that are fulfilling the criteria of 'ancillary activity'. Indeed, analysis of Euronext Paris MATIF derivatives position reports in millet wheat show that 'long' non-hedging positions, speculating on higher prices, by physically trading 'commercial undertakings' in 2022 are up to 15% of all open interests, which is higher than on average in 2019. Given the recent record profits reported by energy and large agribusiness companies, there should be better guarantees that they are not using their knowledge of the market and status of ancillary activity to profit from speculative non-hedging.

Amendments to the current MiFID Art. 2 should change the criteria by which ancillary activity is being accorded by:

- Limiting the total value of trade that can be undertaken by an entity with ancillary activity status;
- Limiting or prohibiting an ancillary activity to be used for non-hedging purposes

Based on the above information and proposals, we would like you to support the changes accordingly to **Markets in Financial Instruments Directive (MiFID) report from rapporteur Danuta Huebner** by approving and voting on the amendments, and related compromises as follows:

- **Amendment 45 to Art. 57 related to position limits on non-hedging positions**
- **Amendment 46 and 47 to Art. 58, paragraph 1 and 4 related to reporting for effective transparency and supervision**
- **Amendment 44 related to Art. 48 related to transparent use of circuit breakers**
- **Amendment 31 -32 to Art. 2 paragraph 1 and 4 related to non-distorting definition of 'ancillary activity'**

The proposed amendments might also support dealing with significant market changes in the future when deliverable supply or open interest will be impacted by changes in agricultural and energy production due to climate change, or by policies to achieve EU Green Deal.

Hoping the above information provides you with additional information how to respond to the call to policy makers to stop too high commodity prices that disrupt the economy and citizens' access to basic needs for energy and food.

Yours sincerely,

The undersigned:

1. Dr. Anna Chadwick, Senior Lecturer in Law, University of Glasgow, and Co-Director of the Glasgow Food Sovereignty Network
2. CCFD- Terre Solidaire, Jean-François DUBOST, Advocacy Director
3. Dr Tomaso Ferrando, Research Professor, Faculty of Law and Institute of Development Policy (IOB), University of Antwerp, Legal Action Committee, Global Legal Action Network (GLAN)
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6. Foodwatch International, Jörg Rohwedder, International Executive Director
7. foodwatch France, Karine Jacquemart, Directrice générale
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10. SOMO, Myriam Vander Stichele, Senior Researcher