

16 February, 2024

By email: cp23-27@fca.org.uk

Priya Kotadia
Financial Conduct Authority
12 Endeavour Square London
E20 1JN

Re: Consultation Paper 23/27; Reforming the commodity derivatives regulatory framework

Dear Ms. Kotadia,

MFA (“**MFA**” or “**we**”)¹ appreciates the opportunity to represent the views of the global alternative investment industry in this written response to the Financial Conduct Authority’s (“**FCA**”) consultation paper on reforming the commodity derivatives regulatory framework (the “**Consultation Paper**”).² We have set out our responses to the relevant questions of the Consultation Paper in the Annex hereto.

MFA is supportive of the FCA’s intentions to mitigate risk through empowering the trading venues to impose more stringent requirements on certain, critical contract sets and would encourage the FCA to continue to engage closely with the US and other international policy and regulatory leaders to ensure continued alignment of the UK market framework in a way that supports cross-border trading. MFA supports aligning the proposed requirements in the Consultation Paper with analogous US requirements, where appropriate.

¹ Managed Funds Association (MFA), based in Washington, DC, New York, Brussels, and London, represents the global alternative asset management industry. MFA’s mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 175 member fund managers, including traditional hedge funds, credit funds, and crossover funds, that collectively manage nearly £1.8 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their Investments, manage risk, and generate attractive returns over time.

² Reforming the commodity derivatives regulatory framework, Consultation Paper 23/27, Financial Conduct Authority (Dec. 2023).

Washington, DC
1301 Pennsylvania Ave NW
Suite 350
Washington, DC 20004

New York
546 5th Avenue
12th Floor
New York, NY 10036

Brussels
40 Rue D’Arlon
1000 Brussels, Belgium

London
14 Hanover Square, Mayfair,
London, United Kingdom, W1S 1HT

Executive Summary

In our detailed comments that follow in the Annex, MFA addresses certain specific questions important to MFA member firms. MFA's comments, set forth in the Annex, are summarised as follows:

- MFA supports applying position limits only to commodity derivatives contracts identified as “critical”;
- MFA supports exemptions from position limits for hedging activities of non-financial firms engaged in hedging activities;
- MFA supports transferring responsibility of setting position limits from the FCA to the trading venues, as they are better-positioned to identify contract types where position limits would be appropriate; and
- MFA does not support enhanced position management controls and reporting because, while enhanced position management controls can offer the trading venue additional colour to assess market impact, imposing a requirement on firms to proactively report the information to the trading venue would be burdensome and negatively affect liquidity.

* * * * *

MFA appreciates the opportunity to provide these comments to the FCA in response to the Consultation Paper. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Jeff Himstreet (jhimstreet@mfaalts.org) the undersigned (jhan@mfaalts.org).

Respectfully submitted,

/s/ Jennifer W. Han

Jennifer W. Han
Executive Vice President and Chief Counsel
Global Regulatory Affairs
Managed Funds Association

ANNEX

Q2: Do you agree with the approach outlined, including the criteria to assess the criticality of contracts? If not, please explain why.

MFA supports applying position limits only to certain “critical” commodity derivatives contracts. FCA is proposing to identify a set of “critical” contracts for which disorderly trading would have the greatest impact on commodity markets and their users. The proposed regulatory framework, where trading venues set position limits for this narrow set of critical contracts and extend the application of the position limit regime to contracts that are sufficiently related to the critical contracts, vests with the trading venues the obligation to determine those contracts for which position limits are necessary and appropriate. MFA supports the judicious and limited designation of contracts as “critical” for purposes of applying position limits.

Q12: Do you agree with the approach to granting exemptions outlined above? If not, please explain why.

MFA supports the approach taken in the Consultation Paper that would create exemptions from the position limits regime for liquidity providers and for financial firms dealing with non-financial firms that are hedging risks arising from their commercial activities. We support the efforts of the FCA to strengthen its rules to provide that the trading venues shall determine whether the use of exemptions remains consistent with the operation of orderly markets. While MFA member firms for the most part are not liquidity providers, MFA supports the exemptions proposed in the Consultation Paper as it would generally harmonise the position limit exemptions that are available in the US and UK, as the Commodity Futures Trading Commission’s (“CFTC”) position limit rule includes comparable exemptions.³

Q16: Do you agree that trading venues should establish accountability thresholds for critical contracts?

The Consultation Paper proposes to vest the principal responsibility for setting position limits with the trading venues, a shift away from the current practice of the FCA setting position limits. MFA supports transferring primary responsibility for setting position limits with the trading venues. While trading venues will be responsible for setting the specific level of position limits, the proposed rules set out the FCA’s expectations as to the factors the trading venue should consider. MFA supports the FCA retaining residual authority to under certain circumstances, set position limits itself, and expect any exercise by the FCA of such authority to be used sparingly, under exigent circumstances.

The trading venues are better positioned to implement position limits, as they have greater day-to-day visibility into trading volumes, patterns, and trends. MFA notes that this proposal, if adopted, would be

³ See Position Limits for Derivatives, CFTC, 86 FR 3236 (Jan. 14, 2021) (adoption position limits rules), avail. at www.govinfo.gov/content/pkg/FR-2021-01-14/pdf/202-25332.pdf.

preferable to the approach taken in the US, where there exist two sets of position limits: one set by rule by the CFTC; and another set by the exchanges.

Q18: Do you agree with the set of conditions that result in the requirement to provide additional reporting? If not, please explain why.

MFA does not support the proposal to require firms to proactively provide additional reporting. MFA supports strong regulatory cooperation and the introduction of enhanced position management by the trading venues. The Consultation Paper would create a new regulatory obligation and expectation for firms regarding the oversight and surveillance arrangements of trading venues as it relates to the venues' position management controls. The proposed rules require trading venues to establish accountability thresholds and to have access to additional information, including information on positions held over-the-counter ("OTC") by members and their clients.

The introduction of enhanced position management controls is a positive development generally, and consistent with US practices. In the US, if a market participant exceeds an account accountability level, the exchange is entitled to ask for information from the market participant regarding the participant's exposures, hedges (if any), and planned trading activity. This additional information requested by the exchange can be helpful to the exchange (for example, understanding how the market participant plans to minimize market impact when exiting a large position).

Unlike the US approach, the FCA's proposal would require market participants to proactively report information to trading venues in certain cases, including when a participant's position in a "critical" or related contract is in excess of an accountability level.⁴ The proposed requirement to obligate firms to develop procedures and controls and operationalise this proactive reporting requirement would impose a considerable compliance and risk burden on market participants.

The information required of the market participant would include information on the participant's (i) related OTC contracts and (ii) related contracts traded on overseas trading venues. MFA does not object to the type of information that would be reported and note that it is generally aligned with analogous US requirements. However, MFA cannot support the proposed requirement that market participants proactively report that information to the exchange whenever an accountability level is exceeded. We also note that other UK trading venues do not require exchange members to report details of client positions with other exchanges, making the proposed requirement particularly onerous.

If the FCA adopts this proposal as proposed, MFA member firms have informed us that for compliance purposes, trading desks may take a conservative approach and treat accountability levels for "critical" contracts as hard position limits to avoid triggering a reporting requirement. Such an approach would have the effect of dampening liquidity in these critical contracts. MFA recommends that the FCA revise the Consultation Paper to obligate market participants to submit the requested information to trading venues on request from the trading venue (or the FCA).

⁴ See Consultation Paper, at 51-52.