

# Unintended consequences of C6 definition

Vegetable oils are traded (amongst others) via the following markets:

- NOFOTA: for soybean oil and rapeseed oil;
- FOSFA: for sunflower oil;

These contracts have no reference to future prices as they are not traded on exchanges. We consider that they do not fall under the definition of financial instrument under MiFID II, Annex 1, Section C for the following reasons:

- Agricultural Physical Forward Contracts
- Execution through physical delivery or circle or wash-out
- Contracts only traded by physical operators (no financials) as a contract execution department is required (regardless of the final manner of executing the contract)
- Not cleared, counterparty risk, even if circled or washed-out result can only be taken in the delivery month

# Unintended consequences of C6 definition

In the absence of future prices and exchanges, buying and selling is performed via the service of a broker (but not exclusively). Under these circumstances, a broker functions as reference and holds an important role in price-discovery and fixation for those oils.

The concern is that brokers may be considered as operating an Organized Trading Facility (OTF) under the definition in MiFID II.

This characterisation would lead to the contracts themselves being caught under C6 definition as financial derivatives. This might put the brokers' business models in jeopardy and create issues for the users of these markets in terms of their ability to hedge the risks in the related products.

# Unintended consequences of C6 definition

FEDIOL has requested NOFOTA and FOSFA to contact their respective broker members to comment on the perceived threat of brokers on FOSFA sunflower oil and NOFOTA soybean oil and rapeseed oil being considered as OTF (Organized Trading Facility) under MIFID and EMIR legislation.

FEDIOL has received input from both associations, whereby their members state that the products traded under these contracts are not financial instruments but merely agricultural physical forward contracts traded by non-financial physical traders. Brokers on agricultural physical forward contracts should not register as OTF.

However, some of these brokers are also brokering contracts which are derivatives (financial instruments) and where they need to register for as an OTF.

# Unintended consequences of C6 definition

Considering the circular reasoning in the **C6 definition**: *“If the intermediaries are OTF’s, then the forwards are derivatives. If the forwards are derivatives, then the intermediaries should be OTF’s”*; this could mean that if one broker dealing with FOSFA sunflower oil and NOFOTA soybean oil and rapeseed oil contracts registers as an OTF (because of dealing in other contracts which are derivatives), FOSFA sunflower oil and NOFOTA soybean oil and rapeseed oil contracts would become derivatives and all brokers would have to register as OTF’s.

# Unintended consequences of C6 definition

This would not only affect the brokers (needing to register as OTF's with all the additional requirements) but it would also affect the companies trading (without brokers) these FOSFA sunflower oil and NOFOTA soybean oil and rapeseed oil contracts, which have suddenly become financial instruments through the C6 definition.

By extension, **this C6 definition could also affect all brokered agricultural physical forward contracts in all sectors (cereals, oilseeds, oils, meals, compound feed, sugar, rice, ...)** whereby one broker is registered as an OTF (because of dealing in other contracts which are derivatives), thereby turning all these agricultural physical forward contracts suddenly into financial instruments.

# Unintended consequences of C6 definition

To avoid this unintended consequence of the C6 definition (intended to assure that intermediaries dealing with derivatives are OTF's and that derivatives are dealt with through OTF's), we argue that agricultural physical forward contracts have to be exempted from this C6 definition:

- agricultural physical forward contracts are not derivatives and therefore brokers dealing with those agricultural physical forward contracts should not register as OTF;
- if a broker is registered as an OTF (because of dealing with derivatives) and also deals with agricultural physical forward contracts, those agricultural physical forward contracts do not become derivatives.