LEGAL REGULATION OF EXCHANGE TRADE IN OIL AND OIL PRODUCTS IN THE UK

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In the UK, oil and oil products are traded at one of the world's largest mercantile exchanges, the London Intercontinental Exchange (ICE Futures Europe), which is a part of the American Intercontinental Exchange (ICE) founded in 2002. The latter is known to all players in the commodity market as a transnational mercantile exchange for trading in various goods. At the London Intercontinental Exchange, almost 50% of the global volume of transactions in futures for oil and oil products in the world is settled. The activities of the Stock Exchange are regulated in accordance with the requirements of the United Kingdom Financial Services and Markets Act 2000 by the controlled Bank of England as well as by the Commodity Exchange Act. The author studies the procedure for conclusion of contracts for supply of oil and oil products, the types of contracts to be concluded, the requirements to the participants of exchange trade, the methods of control over the activities of the participants. It seems that the performed legal analysis can be useful both for subsequent scientific research and for further development of the legal regulation of exchange trade in oil and oil products in the Russian Federation.

Keywords: *energy law, legal regulation of exchange trade in oil and oil products in the United Kingdom, contractual regulation of exchange trade in oil and oil products.*

The United Kingdom is among the 20 major producers of oil and oil products worldwide as well as one of the main exporters and importers of crude oil (in 2017, oil exports increased to 30 million tons) [1].

At present, settlement of transactions for the purchase and sale of oil and oil products is provided for in the country both through over-the-counter transactions (settled under the terms and conditions of the NBP 2015 or the ISDA contract) and through exchange trading.

In the UK, oil and oil products are traded on one of the largest mercantile exchanges in the world, the London Intercontinental Exchange (ICE Futures Europe) [2], which is a part of the American Intercontinental Exchange (ICE) founded in 2002. The latter is known to all players in the commodity market as a transnational mercantile exchange for trading in various goods.

On the London Intercontinental Exchange, almost 50% of the global volume of transactions in futures for oil and oil products is settled.

In the conclusion of a futures contract for oil or oil products, the buyer and the seller may agree to make a transaction on a specific day for the purchase of goods with a price that is set at the moment.

In the conclusion of futures contracts for oil or oil products at the stock exchange, the parties use certain forms of contracts that are approved by the Stock Exchange.

Oil importers and exporters use futures to insure against the adverse effects of changes in the prices for oil and oil products.

The most popular grades of crude oil traded on the London Intercontinental Exchange are Brent Crude and West Texas Intermediate (WTI).

Trading occurs at the electronic platform of the Stock Exchange known as the ICE platform. It is accessible through WebICE software [3]. The exchange trading opens at 01:00 a.m. and closes at 10:00 p.m.

The activity of the London Intercontinental Exchange is regulated by the Financial Services Authority (FSA) of the United Kingdom.

The tasks of the Financial Services Authority include without limitation:

• maintaining confidence in the financial system;

• promoting public understanding of the financial system;

• ensuring the required level of protection for the consumers of financial services;

• eduction of the possibility of using business for the purposes related to financial crimes.

The key functions of this Authority are protection of the rights of the consumers of financial services and control over the legitimate settlement of exchange transactions.

The activities of the Stock Exchange are regulated in accordance with the requirements of the UK Financial Services and Markets Act 2000 by the controlled Bank of England as well as by the Commodity Exchange Act. In accordance with sections 5 and 5a of the Commodity Exchange Act, the basic rule shall be observed so that all contracts are available on the London Intercontinental Exchange platform throughout the trading day.

The activities of trading participants on the Stock Exchange that are registered in the UK are regulated in accordance with the requirements developed by the Financial Services Authority of the United Kingdom [4]. If participants are abroad, activities of these participants as participants of exchange trade are regulated in accordance with the requirements of the regulatory authorities of the jurisdiction of the country in which they are incorporated.

Each participant of the exchange trade shall settle transactions in accordance with the current rules of exchange trading. Therefore, the Stock Exchange also plays the part of a regulator [5]. For non-compliance with this requirement, the Stock Exchange may apply a disciplinary sanction to the participant.

Exchange transactions cannot be registered in the event of expiration of the contract as well as after the end of exchange trading. The Stock Exchange may require the participants of exchange trade to present evidence of the right to make the transaction both before and after its registration. In case violations of the terms and conditions of the transaction are detected, the Stock Exchange may refuse to register it.

Two types of exchange transactions may be distinguished:

1. Commodity futures exchange transactions (EFP, abbreviation for “exchange of futures for physicals”) which make it possible for exchange trade participants to register as the bidders for trade in futures related to forward transactions in energy raw materials (oil, diesel fuel, gasoline, fuel oil, propane, etc.).

In the financial field, the EFP is a transaction between two parties, in which the futures contract is exchanged for the actual physical good. This transaction involves exchange of information about the futures position concluded in private for the relevant position. The meaning of these transactions is to combine the positive aspects of the forward transaction (choice of counterparty, date and place of delivery, grade of the basis asset, etc., no basis) with the advantages of the exchange guarantee system mitigating the counterparty risk. It is important to note that when EFPs are listed on the stock exchange, the volume and the transaction refer to the current trading day, but the price is not announced to the market. The positive aspects mean that the buyer and the seller can choose for themselves more suitable terms and conditions of the transaction. Accordingly, the negative aspect may be that the buyer enters into a contract subject to the terms and conditions that are not entirely beneficial to it.

For example:

The producing company (producer) of crude oil has 2 million barrels of crude unsold oil. The producer believes that the price of crude oil will grow in the future.

On December 10, the buyer of a refinery should have 2 million barrels of crude oil. It has contracts for futures for ICE Brent Crude in the amount of USD80 in anticipation that the oil price will rise from November to December. Therefore, both participants stay for long on the market where prices are expected to grow.

The producer and the buyer agree to exchange the relevant items to meet their needs. The buyer wants to provide the price, quality and terms of delivery it needs. Both parties inform their brokers of the need for settling an exchange transaction. Then the two brokers contact each other and register the transaction on the Stock Exchange. Since both participants believe that the price will rise, the EFP is suitable for their needs ensuring the security of supplies without obligation on price on behalf of the buyer.

2. Transactions in exchange of futures for swaps (EFS), which make it possible for the participants to register to settle transactions involving swap operations (SWAP).

Swap transactions mean an agreement between the parties (in our case, the participants of exchange trading), which implies an exchange transaction of one or several basic assets subject to certain terms and conditions, but after a certain period of time. In practice, swap contracts are executed subject to a contingent payment providing only for the exchange of differences in the price of basic assets (the instruments themselves are not involved in the transaction).

In the conclusion of contracts in the EFP or the EFS forms, hedging on a bilateral basis for settlement of the transactions within a single exchange transaction is allowed, that is, from a legal point of view, upon conclusion of one contract (for example, when the seller of crude oil becomes the buyer of futures, and the buyer of crude oil becomes the seller of futures). Hedging means any opening of positions aimed at insuring other existing exchange transactions.

Futures hedging makes it possible to fix the asset price, the currency rate or the interest rate set by the Stock Exchange at the time of conclusion of the contract, regardless of the date of performance of the contract.

Two types of hedges used for the futures transactions may be distinguished:

1) Buying hedge associated with the acquisition of futures, which secures the buyer's insurance against possible price increases in the future.

2) Selling hedge envisaging sale of physicals in the market, and for the purpose of insuring against possible price reductions in the future, the futures are sold.

Hedging can be full or partial. Full hedging involves insuring risks in the stock market for the full amount of the transaction, which completely excludes possible losses associated with price risks. Partial hedging insures only part of the real transaction.

There is a number of pricing mechanisms that are used upon conclusion of bilateral transactions, which the Stock Exchange accepts as a basis for registering both EFP and EFS transactions:

1. A bilateral contract shall be concluded at a price convertible at the rate of the ICE Futures Europe in accordance with the established rate set by the Stock Exchange at the time of the current transaction, at the agreed date and time.

2. A bilateral agreement shall be concluded between the participants of exchange trading no later than a contract for exchange transactions was concluded. These agreements make it possible to fix the amount at the time of the decision to buy/sell prior to participation in exchange trading.

In the conclusion of the bilateral agreement, it should be remembered that trading in such instruments does not fall within the competence of the Stock Exchange until this document is submitted to the Stock Exchange.

It should be noted that the negotiations on sale or purchase of oil futures will not be considered by the Stock Exchange as a violation of the Rule of the Stock Exchange G.4 and the Trading Procedure 8.3.1, which prohibits preliminary agreement between the bidders.

However, in the conclusion of the bilateral agreement, the participants of exchange trading should meet all requirements specified in Regulation on Market Abuse (EU) No. 596/2014 [6].

There are factors that should be considered upon conclusion of the bilateral agreements at the stock exchange:

1) In case of detection of operations or suspicion of committing a fraud aimed at money laundering between the parties, the Stock Exchange shall refuse to settle such a transaction.

2) All documentation under the bilateral agreement shall be properly executed. It should be taken into account who can and who cannot be a participant of exchange trading. The contract for sale and purchase of oil and oil products should be concluded in the standard form of the Stock Exchange industry contract.

3) The Stock Exchange attempts to register contracts for emission of oil and petroleum product, as these contracts are considered beneficial for the market as a whole. These are contracts that facilitate safe transportation of oil and oil products.

These contracts are new in stock trading. Stock exchanges in the Czech Republic, Romania, Serbia, Slovakia, and Slovenia are trying to promote themselves by supporting trade in forwards and new products, such as contracts for emissions [7]. The New York Mercantile Exchange (NYMEX) has also begun trading in derivatives in 2008, initially through its partner exchange, GreenX. The NYMEX offers a diverse range of products for emissions in both European and US markets of emissions. Some of the most popular futures contracts include European Union emissions trading scheme futures, clean development mechanism futures, joint implementation futures (JI), California emissions trading scheme futures (CA ETS), regional greenhouse gas initiative futures (RGGI), and Climate Action Reserve futures (CAR).

The ICE offers futures for four types of carbon credits:

— EU Allowances (EUAs);
— EU Aviation Allowances (EUAAs);
— Certified Emission Reductions (CERs);
— Emission Reduction Units (ERUs).

Each of these futures includes different emission units and contract sizes.

Futures prices are usually quoted in euros per ton of gas or its equivalent. Other greenhouse gases are quoted as multiples of carbon depending on their potential for environmental impact. Emission exchange products were first proposed by the European Climate Exchange (ECX). The first exchange product of this kind was purchased by the ICE in 2010.

Pursuant to the requirements of futures contracts, the Stock Exchange trades in certified emission reductions (CERs) in accordance with Article 12 of the Kyoto Protocol to the United Nations Framework Convention on Climate Change. The requirements of the Protocol define the basic clean development mechanism (compliance by the parties to the futures contract with the obligations to reduce and limit emissions). Emission futures are traded under the “CER” symbol.

Futures are quoted in euro and eurocents per metric ton with a minimum price fluctuation of 0.01 euro per ton. The contracts listed for March (H), April (J), May (K), June (M), September (U), and December (Z) are traded electronically through the ICE platform.

4) If the price, at which transactions were settled, does not comply with the current market price (is in the range of high or low prices), the Stock Exchange Compliance Department may request additional information to ensure that the transaction is legal.

5) In exceptional circumstances, the Stock Exchange may, at its discretion, permit Basic Trade where the price of the futures contract is outside the parameters. Prior to authorization of this Basic Trade, the Stock Exchange requests additional information (information necessary to specify the terms of the transaction at the Stock Exchange’s discretion) from the parties to the transaction.

EFP/EFS transactions for futures and options for sale of oil and oil products can be settled only at the time set by the Stock Exchange [8].

On the date of expiry of all futures contracts, except for contracts for emissions of oil and oil products (such contracts mean that during the contract month, each participant of the exchange transaction shall take measures on emissions of oil and oil products). EFP/EFS with regard to expiration of the contract shall be submitted within one hour after the expiration of the contract. In the case of emission contracts, the Stock Exchange shall be informed within 30 minutes after the expiration of the relevant contract [9].

In accordance with Part XVIII of the UK Financial Services and Markets Act 2000, the Stock Exchange shall establish efficient mechanisms to investigate and resolve complaints arising out of fulfillment or non-fulfillment of any of the regulatory functions imposed on it [10]. These measures should include legally established procedures for consideration of complaints, which should be fairly and impartially investigated by an authorized person from the Independent Complaints Commissioner, who is independent on the Stock Exchange. The authorized person shall inform both the Stock Exchange and the applicant of the results of its investigation.

However, the law permits possible consideration of the complaint by the Stock Exchange at its own discretion. The complaint resolution procedures include the following steps [11]:

1. The complaint shall be submitted to the management of the Stock Exchange in writing;

2. The management of the Stock Exchange should attempt to investigate and resolve the complaint at its own discretion without involvement of an independent person. If the applicant is not satisfied with the response or proposals of the Stock Exchange to correct the complaint, the applicant may submit the complaint to the authorized person in the Independent Complaints Commissioner;

3. Having examined whether the referred complaint has a valid basis, the Commissioner shall investigate this issue;

4. After due consideration, the Independent Complaints Commissioner shall prepare a report setting out its recommendations, which will be sent in writing to the Stock Exchange and to the applicant. The Commissariat may recommend that the compensation should be paid to the applicant and/or various corrective measures should be implemented. When submitting a complaint, the Applicant undertakes to fulfill any recommendations and requirements to be determined by the Independent Commissioner.

The provisions governing exchange trade provide for a position transfer mechanism available in the Stock Exchange clearing systems, which makes it possible for the users to create a position transfer from one bidder to another, or from one account to another one within one member, provided that the transfer is performed for the same customer.

The exchange position means the current ratio between the obligations for a rise and the obligations for a fall. The buying position corresponds to the total amount of all securities of the market, the selling position, to the total amount of futures sales transactions.

As a rule, a currency SWAP operation is used to transfer a position. Currency swap means payment to be credited or charged to the trading account for the transfer of an open position to the next day.

The transfer of positions is usually acceptable and it does not require the Stock Exchange's permission when the transfer is performed for the same beneficial owner of the position, provided that the transfer is not performed to eliminate any error. The beneficial owner (also referred to as the beneficiary) is a person or several persons who directly or indirectly own a legal entity or have a significant influence on its decisions.

In case of transfer of a transaction in order to change the ownership of an exchange transaction, it is necessary to notify the Stock Exchange at least one business day prior to the scheduled date of transfer. The scheduled transfer cannot be performed within 5 business days prior to the expiration of the relevant month specified in the contract [12].

The transferor shall ensure that the position being transferred is open and available for transfer. The transferee shall be responsible for compliance with all statutory norms and requirements. All data submitted to the Stock Exchange shall be checked for reliability. Upon consideration of requests for transfer of a position, the Stock Exchange may require additional clarifications or supporting documentation from the participants of the exchange trade to confirm the nature and legality of the transfer, the events that caused it and related actions of the employees participating in exchange trade.

The participants willing to make a transfer that does not meet the requirements shall complete an approved request form and submit it to the Stock Exchange. The transactions of which it is necessary to inform the Stock Exchange include:

— Transfers made for the purpose of consolidating positions held by two or more funds that are managed by the same fund manager and are traded by the same investment consultant in accordance with the same strategy;

— Merger;

— Purchase of assets;

— Consolidation;

— A one-time corporate transaction between two or more entities in which one or more entities become successors to the interests of one or more other entities;

— Transfers made where required, and such transfer is in the interests of the Stock Exchange or the exchange market as a whole.

All contracts for sale of oil and oil products are currently eligible for registration as block trades. The block trades mean agreed transactions in futures and options, which in size come within the scope of a definition of a "block", and can be settled outside a public auction at "fair and reasonable" prices.

The exchange block refers to the relations that develop between the participants of exchange trade at the Stock Exchange in the course of various exchange transactions.

Asset allocation (all commodities at the stock exchange are distributed according to asset classes: agriculture, loans, emissions, energy, production tools, forex instruments, interest rates, and metals) is possible in relation to futures or options (fixed income contracts only), which, from time to time, are appointed by the Stock Exchange as asset allocation agreements. All contracts are currently eligible for registration under the asset allocation mechanism.

Block trades can be used for single futures contracts, intra-industry spreads (for example, calendar spreads), inter-industry spreads, volatility transactions, and other combinational trades. Intra-industry spreads mean calendar or *time spreads.*

The spread refers to the difference between the best buying and selling prices for an asset at the same time.

Block transactions can be conducted in relation to futures or options from time to time appointed by the Stock Exchange as block trading contracts. The following block trades are currently eligible for registration:

1. Permanent transactions with one maturity of any futures and 15 minutes reporting time.
2. Intra-group futures. The contracts indicate two months or more. For example, in February each transaction shall be at least 50 lots, so that the amount is equal to 100, which is equal to the minimum size for Brent.
3. Inter-industry futures. The contract indicates from two contract months. For example, for Brent (B) - Jet CIF NWE compared to Brent 1st line (JNB) span, the Brent threshold is 100 lots, the JNB futures contract threshold is 10 lots.

Block transactions can be settled only at certain trading hours and on specific trading days of the Stock Exchange. Block transactions cannot be arranged at any other time or after the expiration of the contract concluded between the participants of exchange trade.

Upon settlement of block trades, commission fee is charged for the transaction. Block trades can be for single futures contracts, internal trade spreads (for example, calendar spreads), inter-industry spreads, volatility transactions, and other combined transactions. The combined transaction means a transaction consisting of two or more months of the contract from the same Contract or various Contracts that are not supported on the ICE platform. Otherwise, they are called strategic deals, such as Fly, Condor, Butterfly, straddle/strangle.

The block transactions can be made only during certain trading hours and on specific days set by the Stock Exchange. Moreover, asset allocation under fixed-income contracts is not allowed on the last trading day during the expiration of the contract.

The stock exchange sets a minimum volume threshold. This is the minimum number of lots that can be sold as a block transaction or asset allocation.

The rules of exchange trading set that the seller shall notify the buyer of the transaction by 12:00 p.m. on the business day and at least

48 hours prior to the delivery date. The seller shall submit documents for delivery to the London Clearing House (LCH) within six days after settlement of the transaction. The Clearing House shall inform the buyer of the availability of the documents. The buyer shall pay for the transaction to the LCH by 12:00 p.m. on the next business day. Then the LCH shall pay to the Seller. It should be noted that the oil products under all settled exchange transactions are delivered within a month in accordance with the requirements of the contract; the product shall be of commercial quality that meets the specifications set by the Stock Exchange.

It seems that the performed legal analysis may be useful for further development of legal regulation of exchange trade in oil and oil products in the Russian Federation.

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