ESMA’s call for evidence on Position limits and position management in commodity derivatives

A Eurelectric response paper

July 2019

Eurelectric represents the interests of the electricity industry in Europe. Our work covers all major issues affecting our sector. Our members represent the electricity industry in over 30 European countries.

We cover the entire industry from electricity generation and markets to distribution networks and customer issues. We also have affiliates active on several other continents and business associates from a wide variety of sectors with a direct interest in the electricity industry.

We stand for

The vision of the European power sector is to enable and sustain:
- A vibrant competitive European economy, reliably powered by clean, carbon-neutral energy
- A smart, energy efficient and truly sustainable society for all citizens of Europe

We are committed to lead a cost-effective energy transition by:

investing in clean power generation and transition-enabling solutions, to reduce emissions and actively pursue efforts to become carbon-neutral well before mid-century, taking into account different starting points and commercial availability of key transition technologies;

transforming the energy system to make it more responsive, resilient and efficient. This includes increased use of renewable energy, digitalisation, demand side response and reinforcement of grids so they can function as platforms and enablers for customers, cities and communities;

accelerating the energy transition in other economic sectors by offering competitive electricity as a transformation tool for transport, heating and industry;

embedding sustainability in all parts of our value chain and take measures to support the transformation of existing assets towards a zero carbon society;

innovating to discover the cutting-edge business models and develop the breakthrough technologies that are indispensable to allow our industry to lead this transition.

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WG Financial Regulation

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Consultation document is accessible via the following link:
https://www.esma.europa.eu/sites/default/files/library/esma70-156-1101_call_for_evidence_position_limits.pdf

Q1 In your view, what impact, if any, did the introduction of position limits have on the availability and liquidity of commodity derivative markets? What are in your views the main factors driving this development, e.g. the mere existence of a position limit and position reporting regime, some specific characteristics of the position limit regime or the level at which position limits are set? Please elaborate by differentiating per commodity asset class or contract where relevant and provide evidence to support your assessment.

The introduction of position limits has increased uncertainty in commodity derivative markets which in turn can lead to reduced liquidity.

As an example, the impact of the introduction of position limits can be observed in the Nordic Power market in the electricity price area differential contracts. One of two market-makers in this product has ceased operating, which leaves a sole market-maker in the contract. All things being equal, managing the remaining market participant's position has become more challenging than previously.

Q2 Have you identified other structural changes in commodity derivative markets or in the underlying markets since the introduction of the MiFID II position limit regime, such as changes in market participants? If so, please provide examples, and where available data, and differentiate per commodity derivative asset class where relevant.

As mentioned above, some market participants have ceased to perform a market-maker role partly due to the increased risk of breaching a limit, especially in non-liquid contracts.

Q3 Do you consider that position limits contribute to the prevention of market abuse in commodity derivatives markets? Please elaborate by differentiating per conduct, per commodity asset classes or contract where relevant and provide evidence to support your assessment when available.

Position limits contribute to the prevention of market abuse, concretely in relation to price manipulation conducts. However, we consider it is not a determinant element of market abuse prevention, while MAR should be considered the more adequate tool for the prevention of market abuse.

Q4 In your view, what impact do position limits have on the orderly pricing and orderly settlement of commodity derivative contracts? Please elaborate by differentiating per asset class or per contract where relevant and provide evidence to support your answer when available.

So far we have not noticed any significant impact of position limits on orderly pricing and orderly settlement in commodity derivative markets; but there is also only a 18-month experience so far which may not allow to draw firm conclusions.

Q5 More generally, and beyond the specific items identified above, what would be your overall assessment of the impact of position limits on EU commodity derivatives markets since the application of MiFID II?

We believe that, with the exception of the limits applied to new and illiquid contracts, the position limit regime introduced by MiFID II is generally working well. Also in the light, that there is still limited experience, it seems appropriate to only refocus of the way the rules are applied rather than an overhaul of the system.

At the same time, the position limits regime has introduced a significant level of complexity in the commodity derivatives markets. In general, rules for the calculation of position limits are not clear enough, which leads to increased uncertainty for market players. Beside this, it is necessary to harmonize the spot month/ other month criteria between the different EU trading venues to facilitate reporting activities; we observe diverting interpretation /implementation across trading venues.

ESMA & NCAs should take into account that different methodologies could favor some TVs over others, disrupting the internal market for financial services.

Q6 Do you consider that position management controls have an impact on the liquidity of commodity derivatives markets? If so, please elaborate, differentiating per commodity derivative trading venues or contract where appropriate.

We consider that position management controls do not have an impact on liquidity of commodity derivative markets.

Q7 Do you consider that position management controls adopted by commodity derivative trading venues have a role on the prevention of market abuse? If so, please elaborate, differentiating per commodity derivative trading venues or contract where appropriate.

In our view there are better tools to prevent market abuse as position limits are effective to prevent only certain types of market abuse.

Q8 Do you consider that position management controls adopted by commodity derivative trading venues have a role on orderly pricing and settlement conditions? If so, please elaborate, differentiating per commodity derivative trading venues or contract where appropriate.

n/a

Q9 If you are a commodity derivative trading venue, please explain how you have been exercising your position management controls since MiFID II application. In particular, how frequently did you ask further information on the size or purpose of a position, on beneficial owners or assets and liabilities in the underlying commodity under Article 57(1)(b) of MiFID II, require a person to terminate or reduce a position under Article 57(1)(c) of MiFID II, require a person to provide liquidity back into the market under Article 57(1)(d) of MiFID II or exercise any of your additional position management controls?

n/a

Q10 Do you have any general comment on the position limit regime and associated position reporting introduced by MiFID II?

We believe that, with the exception of the limits applied to new and illiquid contracts, the position limit regime introduced by MiFID II is generally working well. Also in the light, that there is still limited experience, it seems appropriate to only refocus of the way the rules are applied rather than an overhaul of the system We would like to propose that Trading Venues are obliged to monitor the limit of market participants and provide respective information to market participants. This seems more efficient than that each market participants sets up his own monitoring system.

Q11 In your view, how will EU commodity derivatives markets be impacted by the UK leaving the EU? What consequences do you expect from Brexit on the commodity derivatives regime under MiFID II?

There is concern about the current expectations on market shares for various markets (e.g. CO_2, coal, oil.) without the granting of equivalence. A number of commodities have their primary market in the UK and, because trading is global, it is unlikely trading would migrate to EU venues. If the UK market size is excluded from the calculations of EU market size for purposes of calculating the Ancillary Activity Exemption, for example, that would have a significant impact on market participants' ability to avail themselves of the exemption.

Q12 Taking into consideration the intended purposes of position limits, do you consider that they deliver the same benefit across all commodity asset classes and across all types of commodity derivatives? Please explain.

We believe that the application of position limits to a large number of contracts is redundant and argue for a more focused scope of application. .

Q13 Would you see benefits in limiting the application of position limits to a more limited set of commodity derivatives? If so, to which ones and on which criteria?

Potentially, yes. A better way of handling position limits could be making more market specific, targeted limits which recognise the specific characteristics of certain markets. For example, the focus could be reduced to only commodities which have a particular impact upon the wellbeing of end consumers (e.g. agricultural products).

Q14 More specifically, are you facing any issue with the application of position limits to securitised derivatives? If so, please elaborate.

n/a

Q15 Do you consider that there would be merits in reviewing the definition of EEOTC contracts? If so, please explain the changes you would suggest.

We support the existing EEOTC definition and we see no need to reconsder it.

Q16 In your view, would there be a need to review the MiFID II position limit exemptions? If so, please elaborate and explain which changes would be desirable.

We consider it would be beneficial to reduce or simplify the process for requesting the hedging exemption under art. 8(1) of CDR 2017/591.

Q17 Would you see merits in the approach described above and the additional flexibility provided to CAs for setting the spot month limit in cash settled contracts? Please explain.

From our point of view, it would be convenient to harmonize the criteria of determination of the calendar, referring to the Ttrading Venues consideration of spot and other month´s contracts, fixing a unique criterion around the different Trading Venues in Europe.

Q18 Would you see benefits to review the approach for setting position limits for new and illiquid contracts? If so, what would you suggest?

n/a

Q19 Would you see merits in a more forward-looking approach to the calculation of open interest used as a baseline for setting position limits? Please elaborate.

We do not see the need for changes in the existing methodologies.

Q20 In your view, are there other specific areas where the methodology for calculating the position limits set out in RTS 21 should be reviewed? If so, what would you suggest, and why?

From our point of view, we would like to highlight the differing methodologies used by Trading Venues. We also propose to provide more transparency:

- Position Reporting calculation methodology used by the Trading Venue should be publicly and freely available.
- Trading Venues should effectively disclose in advance any changes on the Position Reporting methodology. They should also notify both market participants and the NCAs of any changes.
- In the calculation methodology, Trading Venues should include, per each instrument and maturity:
  - the period of time when it will be included in the Position Reporting as other-month and the volume affected.
  - the period of time when it will be added on spot-month position and the volume affected.
  - the period of time when it will be excluded by the Position Reporting, because the TV considers it has expired. Specifically, today some Trading Venues include Calendar 2019 positions on their spot-month/other-month while others consider it expired in Dec-2018. As January, Q1 and Cal contracts expire in Dec-19 this definition could lead to an artificial PL spike on the spot-month by the end the year.

A more clear differentiation between those methodologies applicable to NCAs and those applicable to market players would facilitate the activities related to position limits calculation and would improve the level of certainty in the market. Similarly, as financial instruments are traded on different Trading Venues, Market Participants do not always know how much volume of the same product is traded on each Trading Venue. For example, a Market Participant could have a natural exposure of 10 TWh for TTF natural gas, while he does not take into account share of volume that will be hedged on ICE ENDEX (NL) and/or also using XPSF (Powernext SAS) (FR). Moreover, the Market Participant could decide to hedge some of its original exposure using PEG natural gas negotiated in XPOW (FR) which may not be covered by the TTF French hedging exemption and may require a new notification to the same French NCA (partially contradictory with the previous).

NCAs should clearly describe the methodology used for the Position Limit calculations. When the methodology is coincident with the Position Reporting should be explicitly mentioned.

Changes on the Position Limits methodology or the Position Limit values should be effectively disclosed in advance and clearly specify when they come into force.

Q21 How useful do you consider the information on position management controls available on ESMA's website?

n/a

Q22 Do you consider that there is a need to review the list of minimum position management controls to be implemented by commodity derivatives trading venues under Article 57(8) of MiFID II? If so, please explain the changes you would suggest.

n/a

Eurelectric pursues in all its activities the application of the following sustainable development values:

Economic Development

- Growth, added-value, efficiency

Environmental Leadership

- Commitment, innovation, pro-activeness

Social Responsibility

- Transparency, ethics, accountability

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