

ESMA consultation on technical standards for commodity derivatives

A Eurelectric response paper

July 2021

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.

Dépôt légal: D/2021/12.105/33

Questions

Q1 : Do you agree with ESMA's proposal regarding the impact of the new hedging exemption on the aggregation of positions? If not, please elaborate.

Yes. We are of the opinion that since the commodity derivatives entered into by a financial entity are aimed at reducing risks related to the commercial activities of a non-financial company in a predominantly commercial group, the modus operandi of the aggregation of positions should be the same as that of non-financial companies. Therefore, these positions should not be aggregated.

Q2 : Do you agree with ESMA's proposal for positions qualifying as risk-reducing? If not, please elaborate and provide an alternative proposal.

Yes. We are of the opinion that since the commodity derivatives entered into by a financial entity are aimed at reducing risks related to the commercial activities of a non-financial company in a predominantly commercial group, the circumstances under which said positions may qualify as risk-reducing should replicate the circumstances set out in Article 7(1) regarding the positions held by NFEs.

Q3 : Do you agree with ESMA's proposal on the application procedure for financial entities?? If not, please elaborate and provide an alternative proposal.

Yes, we agree with the ESMA proposal.

Q4 : Do you agree with ESMA's proposal on the application procedure for mandatory liquidity provision exemption? If not, please elaborate and provide an alternative proposal.

Yes, we agree with ESMA's proposal as we think the information requested is necessary to prove the nature and purpose of the positions.

Q5 : Do you agree with ESMA's proposal on qualifying positions? If not, please elaborate and provide an alternative proposal.

Yes, we agree.

Q6 : Do you agree with ESMA's proposed definition of financial entities? If not, please elaborate.

Yes, we agree with ESMA's proposal.

Q7 : Do you agree with ESMA's proposal regarding the aggregation and netting of positions in a commodity derivative? If not, please elaborate and provide an alternative proposal where available.

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Q8 : Do you agree with ESMA's proposal for significant volumes? If not, please elaborate.

We support the deletion of the reference to "the same commodity derivative" and the proposed treatment of balmos (other closely related derivatives that are a fraction of the value of a corresponding standard futures contract or whose pricing period is defined as the selected start date to the end of the contract month of the standard futures contract traded on the same trading venue), provided that a clear guidance is given to market participants by ESMA and NCAs about what products shall be aggregated under the same limit.

With reference to the proposal made regarding spreads, we see first a need to clarify the underlying meaning of spread contracts. In the energy business spread contracts are usually no outright contracts but rather strategies where the two legs consist of an outright contract that are executed simultaneously.

If some spread contracts exist directly offered by trading venues and having their own position limits, no disaggregation should be applied in such cases, in order to avoid a double imposition of position limits on market participants.

Q9 : Do you agree with ESMA's proposal? If not, please elaborate and provide an alternative proposal where available.

We do not agree with the proposal to set the baseline for the spot month based on the open interest in case the deliverable supply is significantly higher than the former. This generally happens in less developed, illiquid markets. So if a low limit is set in these cases, it will not be possible for these markets to increase trading, develop further and become more liquid. Therefore, we suggest using the deliverable supply as the baseline for the spot month in all cases.

Q10 : Do you agree with ESMA's proposal? If not, please elaborate.

We agree with ESMA arguments about the possible lack of public data sources over the one-year period immediately preceding the calculation of deliverable supply. However, the impression about the new wording proposed by ESMA is that it does not differ substantially from the original version. We hence propose rephrasing the wording as follows: *"Competent authorities shall determine the deliverable supply for a commodity derivative referred to in paragraph 1 by reference to the average monthly amount of the underlying commodity available for delivery based **on the most recent available data over a representative period of time.**"*

Q11 : Do you agree with ESMA's proposals regarding Article 14 of RTS 21a? If not, please elaborate and provide alternative proposals.

We agree with the ESMA proposal of calculating open interest *"over a representative period of time"*, provided that this period takes into account seasonality trends for each commodity considered (i.e. a more precise definition is required)

We also agree with the specification that the open interest shall be net, as this would have a harmonizing effect on its calculation.

Regarding the proposal of monitoring open interest on the basis of reported data, we believe this methodology can be applied only to contracts traded on a Trading Venue. Including in open interest estimate also contracts reported as EEOTC would inevitably add an element of confusion, as EEOTC classification ultimately depends on evaluations of each company trading OTC.

Finally, we also share ESMA's considerations about open interest calculations in the case of mergers or similar corporate events for trading venues.

Q12 : Do you see merit in the new approach considered by ESMA for new and less liquid agricultural commodity derivatives? If not, please elaborate and provide an alternative proposal.

Not relevant for Eurelectric.

Q13 : Do you agree with ESMA's proposal regarding Article 19 of RTS 21a? If not, please elaborate.

We agree with the proposal in article 19.3 that where the open interest is significantly lower than the deliverable supply, competent authorities shall adjust the other months' position limit upwards to increase trading in these markets. However, we do not agree with the competent authorities adjusting of the spot month position limit downwards.

Q14 : Do you agree with ESMA' proposal regarding the upward adjustment factor to be used in case of a small number of market participants or less than three investment firms acting as market makers? If not, please elaborate and provide an alternative proposal.

Yes we agree with ESMA's proposal.

Q15 : Do you agree with ESMA's proposed amendments to ITS 4? If not, please elaborate.
Not relevant for Eurelectric.

Q16 : Do you agree with ESMA's suggestion to introduce such ongoing position monitoring requirement in the draft RTS? If not, please elaborate.

We generally agree with the proposal for trading venues having arrangements for ongoing position monitoring in place; ideally combined with a respective alert process for trading participants.

However, we are concerned as regards the level at which monitoring requirements and accountability levels should apply. The concept of persons with close links is not a known concept for EU commodity derivative trading venues and they have no access to such information. Furthermore, entities that fall within the category of close links often run have their own independent trading activities and are not allowed to share sensitive information. It is therefore highly recommended that ESMA uses the existing reporting formats, which include information on end position holder and parent undertaking.

Q17 : Do you agree with ESMA's suggestion to introduce accountability levels as part of position management controls? Do you agree with ESMA's assessment that accountability levels would be of particular relevance for physically settled commodity derivatives? If not, please elaborate and provide alternative proposals.

Generally, we think companies are already under burdensome reporting requirements and any new provision of information should be evaluated carefully. We are supportive of trading venues having position management arrangements in place, but we are concerned that the current ESMA proposal will create considerable burdens for both the trading venues and market participants.

Rather than prescribing very detailed provisions for the trading venues in general, we believe that the concept of accountability levels should allow discretion to the trading venues to determine on which contracts to set those accountability levels, when to actively monitor them (spot month and/or other month or even closer to delivery) and whether indeed to request additional information if an accountability level is exceeded.

This would be in line with MiFID II Art. 57 par. 8, which lays down the powers for trading venues to establish position management controls and also be aligned with CFTC rules (which serve as basis for the ESMA concept anyway).

Against this background we propose that in Art. 2 par. 1, 2 and 3, as well as the second part of paragraph 4, the words "shall" should be replaced by "may".

Q18 : In your view, how should accountability levels be set for the spot month and the other months? Based on which methodology or criteria? Should all types of positions count towards the accountability levels?

We think positions qualifying as reducing risks directly related to commercial activities and transactions entered into to fulfil obligations to provide liquidity should not count towards the accountability levels.

In order to get an exemption for these transactions to not count for the position limits, companies have to send to their competent authorities detailed information regarding said positions. Therefore, we consider it should not be necessary to send again this same information regarding the nature and purpose of the position, now to the trading venues.

Q19 : Do you agree with ESMA's suggestion to introduce requirements for the review of accountability levels? Do you also agree with ESMA's proposal regarding reporting requirements to the NCA on accountability levels? If not, please elaborate.

We generally agree with ESMA's proposal.

Q20 : In your view, what other types of position management controls could be further specified in the draft RTS?

As laid out in Q17, we do not consider that additional position management controls, beyond those already proposed, should be further introduced by ESMA. Instead, trading venues should have the discretion to introduce relevant measures, if and where necessary.

Cost Benefit Analysis

CBA Q1: This first question aims at identifying the category of firm/entity you belong to. Please provide the total notional amount traded in commodity derivatives traded on a trading venue (and EOTC contracts where relevant in 2020 in thousand euros and the related total number of trades in the relevant boxes).

Category	Number of employees	Total notional amount traded in 2020 in thousand euros	Number of trades in 2020
Trading venue	[1-50]		
	[51-250]		
	[251-500]		
	>500		
Financial entity	[1-50]		
	[51-250]		
	[251-500]		
	>500		
Non-financial entity	[1-50]		
	[51-250]		
	[251-500]		
	>500		

CBA Q2: for Financial entities: Do you intend to apply for an exemption for risk-reducing positions related to the commercial activities of the commercial entity of the group? What percentage of your positions do these risk-reducing positions account for?

CBA Q3: Do you intend to apply for an exemption for positions resulting from transactions undertaken to fulfil mandatory liquidity provision? What percentage of your positions do these positions account for?

CBA Q4: Is there any specific provision in draft RTS 21a that you would expect to be a source of significant cost? If so, please elaborate.

CBA Q5: Taking into account the size of your firm, would you qualify overall compliance costs with draft RTS 21a as low, medium or high?

CBA Q6: Is there any specific provision in the draft RTS on position management controls that you would expect to be a source of significant cost? If so, please elaborate.

CBA Q7: Taking into account the size of your firm, would you qualify overall compliance costs with amended the draft RTS on position management controls as low, medium or high?

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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