Final CMCE response to the ESMA public consultation on technical standards for commodity derivatives
21 July 2021

Opening comments
The Commodity Markets Council Europe (CMCE) welcomes the opportunity to respond to the ESMA public consultation on technical standards for commodity derivatives. CMCE is highly supportive of efforts to enhance the functioning of EU commodity derivatives markets by optimising the applicable regulatory framework. Accordingly, we commend the European Commission and ESMA for their efforts to introduce targeted reforms to MiFID II/MiFIR through the Capital Markets Recovery Package (CMRP). The reforms to the Ancillary Activity Exemption and the position limits regime reflect a pragmatic and flexible approach on the part of EU policymakers. Once fully implemented, the new regime will allow EU commodity markets to become nimbler and more conducive to the growth of new and nascent commodity markets. The changes introduced are positive in a number of regards in that they represent an adaptation to the post-Brexit reality and nature of the EU market, alleviate regulatory burdens on market participants and enable the growth of new commodity market segments essential to the transition to a more sustainable economy. Accordingly, CMCE is pleased to contribute to this consultation process by providing substantive feedback on the proposals contained in the draft technical standards prepared by ESMA. CMCE is broadly favourable to many of ESMA's proposals. However, in a limited number of cases, we have concerns over the necessity and potential efficacy of the suggested approach – notably in relation to spread contracts, EEOTC position reporting, and position management controls.
Section III: Hedging exemption **Question 1**
Context:

Clarification for the aggregation and netting of positions. A new Article 3(5) is introduced in RTS 21a to clarify that positions held by a financial entity in commodity derivatives that are objectively measurable as reducing risks directly related to the commercial activities of NFEs in a predominantly commercial group, as approved by the competent authority pursuant to Article 7(2) and (4) of RTS 21a, shall not be aggregated for the purposes of comparing the net position of that financial entity with the limits for that commodity derivative.

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

CMCE answer

CMCE agrees with ESMA's proposal.

Question 2

Context:
Definition of qualifying positions. Under Article 7(2) of RTS 21a, the circumstances under which a position held by a financial entity in relation to the commercial activities of the NFEs of the group may qualify as risk- reducing therefore replicate the circumstances set out in Article 7(1) regarding the positions held by NFEs. Likewise, Article 7(4) of RTS 21a sets out requirements regarding the information to be included in the financial entity's internal policies and the availability of a sufficiently disaggregated view of the hedging portfolios, in line with the provisions set out in Article 7(3) for NFES.

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

CMCE answer

CMCE agrees with ESMA's proposal.

Question 3

Context:
The determination of the application procedure for the exemption from PL for financial entities.

- ESMA considers that it would be more straightforward for both market participants and NCAs to draft a hedging application procedure for financial entities that would mirror the application procedure for NFEs to the extent possible. Like NFEs, the financial entity holding a qualifying position must apply for an exemption from position limits to the NCA which sets the position limit for that commodity derivative as that NCA will be the one receiving daily position report from the financial entity (Article 8(3) of RTS 21a).

- The information submitted to the NCA should demonstrate that the parent undertaking has entrusted to the financial entity the trading of commodity derivatives traded on a trading venue and their economically equivalent OTC contracts to reduce the exposure and risks in the commercial activities of the non-financial entities of the predominantly commercial group.

- Further adjustments to the application procedure for NFEs are also needed in Article 8(4) of RTS 21a to cater for the fact that the financial entity will have to demonstrate that the position reduces risks directly related to the commercial activities of the non-financial entities of the group, and not of its own commercial activity.

- The application file should continue to include a description of the nature and value of the NFE's commercial activities in the commodity derivative for which an exemption sought is relevant. Information should also be provided on the exposures and risks in the commodity which the NFE has or expects to have as a result of its commercial activities, and which are or would be mitigated by the use of commodity derivatives.

- The financial entity must provide a description of the nature and value of its activities in the relevant commodity derivatives and an explanation of how its use of commodity derivatives directly reduces the exposures and risks in the commercial activities of the NFEs of the predominantly commercial group.

- ESMA proposes to retain the same 21 calendar day period for the NCA to approve or reject the financial entity's application and notify its decision to the applicant. ESMA also proposes to retain the same procedure as currently set out in Article 8(4) of RTS 21 in case of a significant change in the NFE's commercial activities or in the financial entity's trading activities in commodity derivatives and the change having an impact on the information provided at the time of application

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

CMCE answer

CMCE agrees with ESMA's proposal.

Section IV: Exemption from position limits for positions resulting from liquidity provision

Question 4

Context:
RTS 21a includes two specific provisions compared to RTS 21:

i. The aggregation and netting of positions (Art. 3(6) of RTS 21a):

- Clarifies that positions resulting from transactions entered into to fulfil obligations to provide liquidity on a trading venue, as approved by the relevant NCA pursuant to Article 9 of RTS 21a, shall not be aggregated for the purposes of comparing the net position of that person with the limits for that commodity derivative.

ii. The determination of the application procedure for the exemption from PL (Art. 9 RTS 21a):

- ESMA proposes that the procedure to apply for a position limit exemption in the context of mandatory liquidity provision on a trading venue ("liquidity provision exemption") draws on the current procedure for NFEs to apply for a hedging exemption but with adapted information to be provided at the time of application to cater for the different circumstances.

- Application would be made to the NCA that sets the position limit for the commodity derivative for which mandatory liquidity is provided on a trading venue as this is the NCA receiving position reports from the liquidity provider.

- As one of the key eligibility criteria for the exemption is that the person providing liquidity in commodity derivatives on a trading venue is under the obligation to do so, as opposed to acting on a voluntary basis, the information provided to the NCA at the time of application should include the legal basis for this mandatory liquidity provision and the agreement signed with the trading venue setting out the liquidity provision obligations to be met by the applicant on the trading venue per commodity derivative. The information provided in the application file should also enable the NCA to understand the nature and value of the person's activities in the trading of the relevant commodity derivative pursuant to mandatory liquidity provision activities and of the expected resulting positions.

- As for the other applications for exemption from position limits, the NCA should approve or reject the application within 21 calendar days. Significant changes in the nature and value of the person's trading activities in the relevant commodity derivative that impact the information provided at the time of application should lead that person to submit a new application if it intends to continue using it. This will ensure that the positions reported as exempted from position limits remain consistent with the information available to the NCA on the person's trading activities pursuant to mandatory liquidity provision.

Question:
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.

CMCE answer

CMCE agrees with ESMA's proposal.

Question 5

Context:
The definition of qualifying positions (Article 10 of RTS 21a). ESMA proposes that a position held by a person in a commodity derivative traded on a trading venue qualifies as resulting from transactions undertaken by the person to fulfil mandatory liquidity provision obligations where the position directly results from transactions in a commodity derivative undertaken in compliance with the written agreement entered into with the trading venue and is identified as such by the trading venue, in accordance with the second paragraph of Article 48(3) of MiFID II. It would be for the liquidity provider to ensure that its own records of transactions undertaken to comply with the written agreement entered into with the trading venue are consistent with the trading venue's records.

The person's internal policies should be such as to ensure that the positions resulting from transactions undertaken to fulfil mandatory liquidity provision can be properly identified. To that end, those internal policies should describe the link between the position held in a commodity derivative and the transactions undertaken to fulfil mandatory liquidity provisions as well as the measures adopted to ensure that any position not resulting from mandatory liquidity provision transactions or serving a different purpose can be clearly identified.

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

CMCE answer
CMCE agrees with ESMA's proposal
Section V: Other amendments to RTS 21 **Question 6**
Context: **Definitions in Article 2 of RTS1a.** Article 2 of existing RTS 21 defines NFEs as legal or natural persons other than the ones listed below in the Article. Article 2 of RTS 21a builds on the RTS 21 list of NFEs but turns it into a positive list of legal or natural persons defined as financial entities. Article 2 of draft RTS 21a also clarifies that a a third-country entity would be considered as a financial entity if it would require authorization under any of the aforementioned legislation if it were based in the Union and subject to Union law. NFEs are then in turn defined as legal or natural persons not qualifying as financial entities. Question: *Do you agree with ESMA's proposed definition of financial entities? If not, please elaborate.*
CMCE answer
CMCE agrees with ESMA's proposal.
Question 7
Context: **Aggregation and netting of positions in a commodity derivative (Article 3 of draft RTS 21a)**

Draft RTS 21a would make two sets or amendments to Art. 3 of RTS 21:

1. The deletion of the reference to "the same commodity derivative" in Article 3(1) of RTS 21 as a consequence of its deletion from Art. 57(6) MiFID II.

2. A more nuanced approach for the netting of positions for spread contracts and for commodity derivatives:

    - ESMA proposes to set out in Level 2 that position limits should apply to outright contracts and that the use of spread contracts should be included in the limits set for those outright contracts.

    - ESMA proposes to aggregate the positions of commodity derivatives that are based on the same underlying and share almost the same specifications as the principal or main commodity derivative traded on the same trading venue, such as "minis" and "balmos".

Question:
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.

CMCE answer

CMCE agrees in principle with ESMA's proposals with regard to the deletion of the reference to 'the same commodity derivative' to simplify the calculation of position limits for commodity derivatives that may be traded on trading venues in more than one jurisdiction. We note, however, that the draft language in article 3(1)(a) and (b) of draft RTS21a uses the formulation "….based on the same underlying and sharing the same characteristics traded … on other venues…". The Level 1 governing provision (article 57(6) of MiFID2) clearly limits this to "other *trading* venues" rather than to "other venues". For the avoidance of confusion, it would be better to reflect the Level 1 language more closely here.

CMCE also agrees in principle with the approach to aggregating 'minis' and 'balmos' transactions in the interest of simplicity. We note however that the reference to "balmos"/"minis" in article 3(2) of draft RTS21a should be limited to "commodity derivatives *traded on a trading venue* , that are a fraction of the value etc.". As currently drafted, it would appear to catch OTC contracts, which is clearly not the intention described in the CP.

However, CMCE does not consider it necessary to include a reference to spread contracts. According to the experience of CMCE Members, the existing rules operate in such a way as to capture the constituent derivative contracts that form the basis of the spread contract. As a result, applying position limits to spread contracts would appear to be unnecessary and challenging given their heterogenous characteristics. Spread contracts are not listed as separate contracts but rather as a facility to enter into two legs in the outright contracts executed at the same time. The contracts that form the two legs are already subject to position limits. Including a reference to spread contracts is, therefore, unnecessary, adds a duplicative position limit and would give rise to an additional layer of complexity. CMCE does not see any regulatory benefit from this proposal, as the positions in the outright contracts would already be protected.

CMCE also notes that in the event a trading venue admits to trading a differential contract whose contract terms reflect the economics of two separate outright markets (for example a cash settled contract which reflects the difference between two separate outright contracts), a separate position limit is also not required. Instead, the position in the differential contract can be deconstructed into equivalent long and short positions and aggregated with any positions of the respective outright markets reflecting the economics of the differential.

Consequently, CMCE recommends that ESMA should remove the reference to spread contracts.

Question 8

Context:
Significant volumes (Article 5 of draft RTS 21a). As a direct consequence of the amending Directive (see paragraph 41), the reference to "Same commodity derivatives" has been deleted in Article 5 of RTS 21a. The definition of a commodity derivative "traded in significant volumes on a trading venue" has been adjusted to refer to an agricultural commodity derivative where the average daily open interest exceeds 20,000 lots in the spot month and other months' combined. The former threshold of 10,000 lots has been adjusted upwards to 20,000 lots to be consistent with the proposal made in Article 17 of draft RTS 21a for new and less liquid agricultural commodity derivatives.

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

CMCE answer

CMCE agrees with ESMA's proposal.

Question 9

Context:
Methodology for determining the baseline figure for spot month limits (Article 11 of draft RTS 21a). ESMA proposes to set out in Article 11(1) of RTS 21a that, where the deliverable supply is significantly higher than the open interest, the NCA should set the baseline for the spot month limit as 25% of the

open interest. The same approach would apply for setting the baseline for commodity derivatives with an underlying that qualifies as food for human consumption under Article 11(4) of RTS 21a. Once the baseline for the spot month limit has been determined, the NCA should then consider the relevant adjustment factors available in draft RTS 21a, including to ensure that the spot month limit is consistent with the objectives of Article 57 of MiFID II.

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

CMCE answer

CMCE has concerns about ESMA's proposal, which it considers to be unnecessary, and believes it could have unintended adverse consequences.

ESMA's proposal is that where "deliverable supply is substantially higher than total open interest", NCAs would set the baseline figure for a spot month limit at 20% of the open interest and not by reference to deliverable supply. ESMA's rationale for this is that in these circumstances *"the spot month limit is therefore deprived of any material effect, in contrast to the objectives of position limits set out in Article 57(1) of MiFID2".* Recital 127 of MiFID2 explains those objectives as being *"…in order to prevent market abuse, including cornering the market, and to support orderly pricing and settlement conditions including the prevention of market distorting positions. Such limits should promote integrity of the market for the derivative and the underlying commodity without prejudice to price discovery on the market for the underlying commodity …".*

Limits protect market integrity in spot month contracts by reducing the potential for the contract to become subject to an abusive squeeze (cornering). This risk materialises where there is sufficient constraint in the deliverable supply for there to be a real risk that participants wishing to make delivery would not be able to do so (commercially) at month end.

That risk does **not arise** in circumstances where the deliverable supply is substantially higher than the open interest. In those circumstances, not only would there be no risk of the market being cornered. In any event – clearly – imposing a limit on open interest (rather than on the deliverable supply) would not guard against any cornering risk. It would be a limit for the sake of a limit. This means that open interest is not the appropriate proxy to set a position limit.

It would potentially have some unintended consequences, reducing or placing a cap on liquidity in the spot month contract, which might impair the pricing of that contract and reduce the hedging benefit it presents to the market.

CMCE is not aware of any similar requirement under the rules of any other jurisdiction in respect to spot month contracts.

CMCE, therefore, requests ESMA to reconsider this proposal.

Question 10
Context: **Deliverable supply (Article 12 of draft RTS 21a).** ESMA proposes to clarify in Article 12(2) of RTS 21a that the deliverable supply should be determined by reference to the average monthly amount of the underlying commodity available for delivery based on the most recent available data covering a one-year period immediately preceding the determination. Question: *Do you agree with ESMA's proposal? If not, please elaborate.*
CMCE answer
It is the CMCE aim to ensure that the methodology works for all asset classes. Therefore, the CMCE would suggest the same approach as the one proposed to determine the open interest figure in Article 14 of draft RTS 21a. It establishes that the NCA calculates deliverable supply "over a representative period of time" which would depend on the characteristics of the commodity derivative. In our view, this would allow for an appropriate approach to be found for all asset classes. CMCE believes that the approach adopted should be sufficiently flexible to ensure that the default measure used as a proxy does not turn out to be materially unrepresentative. Supply figures vary year-on-year in all commodity asset classes, and – to take an obvious example – the deliverable supply of wheat in a drought year would be a misleading measure to use for a good weather year. We therefore recommend that any such process should incorporate sufficient flexibility to allow for an exercise of judgement, on the basis of input from the relevant trading venues.
Question 11
Context: **Open interest (Article 14 of draft RTS 21a).** ESMA proposes to introduce three clarifications in the calculation of open interest in Article 14(1) of RTS 21a: • As position limits apply to commodity derivatives traded on a trading venue and EEOTC contracts, ESMA proposes that the reference amount used for setting those limits also include open interest in EEOTC contracts, which is now spelled out in Article 14(1) of RTS 21a.

- ESMA agreed with NCAs that the open interest should be calculated on a net basis, based on position reporting data. As the Level 1 text refers to the "net open interest" in a commodity derivative to assess whether that commodity derivative qualifies as critical or significant, ESMA proposes that the same open interest calculation methodology applies to all commodity derivatives subject to position limits, including agricultural commodity derivatives. Furthermore, ESMA considers that the calculation of open interest based on position reporting data provides the most accurate and reliable figure while promoting convergence in the setting of position limits by NCAs. Article 14(1) of RTS 21a therefore clarifies that the net open interest in a commodity derivative must be determined based on position reporting data.

- ESMA proposes for the open interest to be calculated "over a representative period of time" which would depend on the characteristics of the commodity derivative. For instance, where trading in a commodity derivative is subject to seasonality effects, a sufficiently long period of time should be considered to remove this data bias. Where trading in a commodity derivative is in a rapid upward, or downward, phase, a shorter reference period may be more appropriate for the calculation of open interest to better capture market trends.

    - ESMA also proposes to introduce a second paragraph in Article 14 of RTS 21a to cater for the calculation of open interest in certain specific circumstances. As experienced over the last three years, following a merger or other corporate events, a commodity derivative may be transferred from one trading venue to another. Alternatively, a new commodity derivative may be admitted to trading on a trading venue to gradually replace an existing one, in case for instance of a change in the underlying index. In both circumstances, considering the newly launched commodity derivative as a “new” contract for position limit purposes would not allow to appropriately capture potential trading interests in that contract and would hamper the adequate development of this contract. ESMA is therefore of the view that when first setting a position limit for such commodity derivative, the NCA should be able to take into consideration the open interest in that commodity derivative on the former trading venue or in the commodity derivative to be gradually replaced.

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

CMCE answer

CMCE agrees with the majority of ESMA’s proposals in relation to the calculation of open interest, as set out in Article 14 of the draft RTS 21a. Since the practice applied by NCAs has been subject to variation it is worth clarifying that open interest is to be calculated on a net rather than gross basis, consistent with the provisions of the Level 1 text.

It is also important to ensure that NCAs use comparable data sources to guarantee that open interest is calculated consistently. Accordingly, we agree that position reporting data provides a sound basis for the determination of open interest.

That said, in order for position reporting data to be established as a reliable, CMCE believes that ESMA and NCAs will have to increase their efforts to verify the accuracy of position reports – particularly when related to EEOTC contracts.

While CMCE understands ESMA's proposed approach to calculating open interest by accounting for both trading activity on trading venues and in EEOTC contracts, we have doubts as to the practicability of this proposal. EEOTC contracts should only be included in the calculation of open interest once ESMA or NCAs have verified whether the contract genuinely qualifies as EEOTC.

CMCE notes that ESMA's policy intention has always been to ensure that EEOTC are defined in a narrow manner, so as to limit the scope for firms to seek to avoid the impact of position limits unduly. This being so, it would be important for ESMA to ensure that a regime which includes EEOTC position reports should only include such reports when properly made. Otherwise, over time, if ESMA includes unfiltered EEOTC position reporting data in its open interest assessments, this will inevitably create the conditions for EEOTC to become accepted as a wider category.

CMCE notes that it is essential to align the EU regulatory efforts with other jurisdictions to ensure an internationally consistent framework which would work for globally active stakeholders, and which would ultimately benefit the European economy.

Question 12

Context:
New and less liquid agricultural commodity derivatives (Article 17 of draft RTS 21a).

In Article 17 of RTS 21a, ESMA is considering to simplify the methodology for new and less liquid agricultural commodity derivatives and use the same de minimis position limit for all agricultural commodity derivatives with an overall open interest below 20,000 lots over a consecutive three-month period. For those commodity derivatives, the position limit would be set at 10,000 lots for the spot month and 10,000 lots for the other months. The aim of this new approach to de minimis position limits for new and less liquid agricultural commodity derivatives would be to allow those contracts to grow and stabilise, without hindering market participants to trade from the start or shortly after for fear of breaching overly restrictive limits. When an agricultural commodity derivative has gathered sufficient trading interest and the open interest has exceeded 20,000 lots, the NCA would then determine bespoke position limits for the contract, in accordance with the methodology set out in RTS 21a.

Question:
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.

CMCE answer
CMCE supports the changes to RTS 21 proposed by ESMA which would effectively impose a limit of 10.000 lots on all new and less liquid agricultural commodity derivative contracts below 20 000 lots (50 percent of the baseline). Contracts currently classed as ‘illiquid’ under the position limits framework receive a standardized limit of 2.500 lots and thereby effectively get a highly restrictive limit (resembling a baseline limit of 25 percent of open interest) when open interest increases close to 10.000 lots. And whilst in theory, in line with ESMA Q&A’s on ‘commodity derivative topics’, NCA’s can use different derogations for illiquid markets which have an open interest between 5.000 and 10.000 lots, these remain difficult to apply in practice and are often not sufficient to mitigate the negative impact of disproportionately low position limits. Once the limit is reached, participants withdraw from the market, often switching to another trading venue outside of the MiFID II regime, thereby leaving the regulator no time to adjust the limit upwards.
Question 13
Context: **The overall open interest (Article 19 of draft RTS 21a).** Based on the experience gained with the issuance of opinions on the position limits notified by NCAs, ESMA is of the view that further clarification should be introduced in the adjustment factors currently set out in Article 18(2) and (3) of RTS 21 which are based on a comparison between the size of deliverable supply and open interest. Where the open interest is significantly higher than the deliverable supply, ESMA considers useful to clarify in Article 19(2) of RTS 21a that it is the other months' limit that must be adjusted downwards so as to avoid a cliff-edge effect with the spot month limit which is based on deliverable supply. That cliff-edge effect should not be addressed by adjusting the spot month limit upwards due to an increased risk of market cornering in such circumstances. Where the open interest is significantly lower than the deliverable supply, ESMA is of the view that the other months' limit should be adjusted upwards to avoid the risk of unduly constraining trading. In contrast, as deliverable supply is significantly higher than open interest, the spot month limit based on deliverable supply that results from the baseline is expected to exceed the open positions held by market participants in the spot month. To avoid that the spot month is deprived of any effect and to ensure that it does prevent market participants from building a dominant position that would be contrary to the objective of preventing market abuse and ensuring orderly, the spot month limit should be adjusted downwards. This is clarified in Article 19(3) of RTS 21a.

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

CMCE answer

CMCE is supportive of clarifying in Art. 19 par. 3, that where the open interest is significantly lower compared to the deliverable supply, NCAs shall adjust the other months' position limit upwards to avoid the risk of unduly constraining trading.

However, the CMCE Members disagree with the need to adjust the spot month position limit downwards when open interest is relatively low compared to deliverable supply. In line with our answer to Q9 that, we do not see an increased risk of market manipulation in these situations. New contracts will always have a relatively low amount of open interest in their initial stages of development. There is no evidence to suggest that a more restrictive position limit provides any benefit to ensuring the orderly functioning of the market when there are no clear limitations in deliverable supply capacity. The CMCE Members are concerned that, if adopted, the ESMA proposal would hamper the development of such illiquid markets, without providing any benefit.

Question 14

Context:
The number of market participants (Article 20 of draft RTS 21a). ESMA makes two proposals:

- Under Article 19(2) of RTS 21, the NCA may increase the spot month and the other months' limit up to 50% when there are less than ten market participants holding a position in a commodity derivative or when there are less than three investment firms active as a market maker in a commodity derivative. However, according to ESMA, those specific circumstances do not establish a reason for an upward adjustment on their own. ESMA is of the view that a small number of market participants justifies increasing the position limits up to 50% of the reference amount on their own, even without additional available upward adjustment factors. When the number of market participants trading a given commodity derivative is low, one of those market participants is more likely to reach a position representing a significant share of the overall open interest than in case of a more widespread participation without the intention of building a dominant position. NCAs should therefore have the possibility to increase the position limit based on that sole circumstance.

- As regards market makers, ESMA proposes that NCAs should be able to adjust the position limit upward up to 50% of the reference amount when the commodity derivative is an agricultural commodity derivative with a net open interest below 300,000 lots and when there are less than three market makers in that agricultural commodity.

Those two proposals are reflected in Article 20(2) of RTS 21a which provides that "[...] NCAs shall adjust the position limit upwards [...]" (a) where there are less than ten market participants or (b) where the commodity derivative is an agricultural commodity derivative with a net open interest below 300,000 lots and there are less than three investment firms acting market makers in that agricultural commodity derivative.

Question:
Do you agree with ESMA's 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.

CMCE answer

CMCE supports ESMA's proposal to adjust the position limit upwards where there are less than ten market participants or where the commodity derivative is an agricultural commodity derivative with a net open interest below 300,000 lots and there are less than three investment firms acting market makers in that agricultural commodity derivative.

PART II: Amendments to ITS 4

Question 15

Context:
Hedging exemption for financial counterparties from the position limit regime

- ESMA believes it is necessary it is necessary to ensure that in ITS 4, the risk-reducing positions of financial entities that are part of a predominantly commercial group and are acting on behalf of a non-financial entity, are reflected in both daily and weekly reports.

Impact on weekly reports under Article 58(1)(a)

- ESMA is of the view that the published weekly reports should provide the same level of transparency: it should be possible to identify hedging versus non-hedging positions, irrespective of the type of counterparty (financial or non-financial) undertaking the activity.

- In ITS 4, Table I of Annex I already includes a breakdown for "Risk Reducing directly related to commercial activities". Currently, this line is expected to be populated only in the case of non-financial entities. Once the amending Directive takes effect, ESMA proposes the same line be used by financial entities. Hence, there is no need to amend Annex I of ITS 4 in this respect.

Liquidity provision exemption from the position limit regime

- ESMA has not identified any clear benefit of making the positions benefitting from the liquidity provision exemption visible in the weekly reports. As such, ESMA identifies here is no need either to introduce this exemption in daily reports.

Exclusion of securitised derivatives from the position limit regime

- The amending Directive introduces an exemption from the position limit regime for securitised derivatives. As a result, all references to securitised derivatives must be deleted from ITS 4.

Question:
Do you agree with ESMA's proposed amendments to ITS 4? If not, please elaborate.

CMCE answer

CMCE agrees with the proposal to delete securitized derivatives, and believes that also the rest of the amendments will improve the regime set by the ITS 4.

PART III: Draft RTS on position management controls

Question 16

Context:
ESMA is considering proposing to introduce in Level 2 the following arrangements to be implemented by trading venues trading commodity derivatives, taking into account the characteristics of the commodity derivatives traded. Those proposals are reflected in the draft RTS on position management controls available in Annex III.

General monitoring obligations:

- ESMA proposes to specify that the ongoing monitoring of positions held by persons with close links should be part of the position management controls implemented by trading venues, as reflected in Article 1 of the draft RTS on position management controls. The term "Persons with close links" refers to Article 4(35) of MiFID II.

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

CMCE answer

CMCE acknowledges that the revised scope of the position limits regime necessitates a more consistent, harmonised approach to position management requirements at the level of trading venues. As ESMA notes in Paragraph 108 of the consultation paper, trading venues are already required to ensure fair and orderly trading and maintain position management controls that reflect the specific risks associated with commodity derivatives trading on their platforms. The primary role of trading venues has contributed to meaningful and pragmatic position management controls with notable trading venues even establishing position controls below the limits mandated by regulation, as alluded to by ESMA.

In principle, CMCE agrees that, where appropriate and justifiable, a requirement to conduct ongoing position monitoring could be introduced. However, it is imperative that trading venues be granted discretion to initiate more regular periodic monitoring or 'ongoing' monitoring of positions held by market participants active on their platform only in specific cases where such monitoring would be warranted. We would strongly caution ESMA against adopting a prescriptive, 'one-size-fits-all' approach when devising requirements for position management controls given the heterogeneity among trading venues and market participants active in commodity markets.

This response should be read in conjunction with the CMCE answer to Question 17.

Question 17

Context:
Accountability Levels

- ESMA considers it would be appropriate to specify in the RTS on position management controls the circumstances where trading venues should notably exercise the power set out in Article 57(8)(b) of MiFID II to require additional information on the positions held in those commodity derivatives and take appropriate action as necessary in accordance with Article 57(8)(c) and (d) of MiFID II.

- ESMA therefore suggests that trading venues should be required to set out accountability levels in the spot month and in the other months at least for each physically- settled commodity derivative made available for trading, as reflected in Article 2 of the draft RTS on position management controls. Trading venues should also consider whether it is appropriate to set accountability levels for the other commodity derivatives available for trading. Accountability levels would refer to a level of net position held by persons with close links that the trading venue may consider as a potential source of concern or trigger alarm. Where the accountability level would be exceeded, the trading venue would have to make use of the power set out in Article 57(8)(b) of MiFID II and require additional information on the purpose and rationale of the position held.

- After assessing the information received, and where necessary, the trading venue would make use of the powers set out in Article 57(8) (c) and (d), i.e. require the position holders to reduce their positions or provide liquidity back to the market at a given price and time if fitted to the characteristics of the trading venue. However, ESMA notes that members, as well as their clients, could hold positions that are in excess of the accountability levels and that a request for information on the rationale of the position does not necessarily trigger a formal action from the venue where the trading venue' potential concerns would have been addressed by the information received.

- ESMA is of the view that accountability levels should be calibrated taking into account the characteristics of the physically settled contract traded and of the underlying commodity, as well as the contract trading characteristics. As a preliminary consideration, ESMA would also suggest that accountability levels may or may not differ for the spot and for the other months and that positions under common control or ownership should be aggregated for the purpose of the calculation of accountability levels.

- At this stage, ESMA would be minded to keep an open approach to the methodology to be used by trading venues for setting accountability levels in the RTS. However, ESMA also considers that there would be value in developing some further guidance on the methodology, taking into account the characteristics of the in-scope commodity derivatives, to contribute to a harmonised approach and level playing field across trading venues. ESMA intends to conduct further work in this area but would already welcome suggestions from stakeholders on how accountability levels should be set.

Question:
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.

CMCE answer

As noted by ESMA in the consultation paper, the practice of establishing accountability levels is well established among trading venues. The accountability levels are set by individual trading venues and tailored to the specific conditions of their platform and the wider market for the related instruments Accountability levels, if set as per the ESMA proposal, would require a far more regular exchange of information on positions than is necessary to protect market integrity. The regime could quickly become excessively burdensome and bureaucratic for both market participants and trading venues. Firms and trading venues would incur significant costs in terms of time, energy and effort without contributing in a meaningful sense to the preservation of orderly trading in commodity derivatives markets.

CMCE believes that it is essential for trading venues to be able to establish and adapt their own methodologies when establishing accountability levels. The venues should have full discretion in identifying the markets and periods to which the measures should apply. The venues should also have the discretion to establish whether further investigations and information requests are appropriate when an accountability level is breached. Ultimately, individual trading venues are most familiar with trading dynamics on their platform, the behaviour of market participants and the intricacies of the market, and thus best situated to devise the most appropriate methodology.

CMCE therefore recommends that trading venues retain the necessary discretion (i) in setting accountability levels for appropriate products, and (ii) as to whether to take any action (and if so, what) when a level is exceeded. This would require the word "shall" to be replaced by "may" in Article 2 paragraphs 1, 2, 3 and the second part of paragraph 4.

For the sake of completeness, the CMCE notes that providing the trading venues with the discretion to set the accountability levels as they deem it necessary and appropriate would be in line with the CFTC rulemaking on position management controls, as well as with MiFID II Art. 57 par. 8, which lays down the powers for trading venues to establish position management controls. Accordingly, as a general comment, we would strongly advise ESMA against prescribing a common methodology or approach to setting accountability levels in future.

Further, we note that ESMA's proposal would require trading venues to set accountability levels on positions held by firms and their "close links". We would ask ESMA to consider this element carefully. It is not entirely clear how "close links" are intended to be defined, but it will be important to ensure that it does not give rise to breach of confidentiality or insider dealing risks for market participants. Participants in commodity derivatives markets often enter into joint ventures (JV) with non-group companies, subject to confidentiality restrictions and often have to impose information barriers between their trading functions and those trading on behalf the JV. In those cases, it would neither be possible nor legal for firms (a) to obtain information as to their JV partner's trading position or (b) to manage their own position by reference to that information.

CMCE therefore recommends the deletion of the 'persons with close links' requirement throughout the new ESMA draft RTS on position management controls.

Question 18

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?

CMCE answer

In view of the heterogeneity of trading venues and market conditions, CMCE believes that trading venues should be granted discretion to determine the optimal approach to the accountability levels introduced on their platforms. Trading venues should also be able to react promptly to market dynamics and adapt their accountability levels where appropriate.

Question 19

Context:
Accountability Levels

To ensure that NCAs receive adequate information on the position management controls in place, ESMA is also of the view that trading venues should communicate to their NCA the details of the methodology used for setting accountability levels.

Similarly, ESMA is proposing that trading venues submit to their NCA on a yearly-basis details of how accountability levels were applied in practice, including (i) how many times those were exceeded, (ii) how many further information requests were made by the trading venue (iii) the follow-up actions taking by the trading venue.

Question:
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.

CMCE answer

CMCE believes that trading venues can be relied upon to regularly review the appropriateness of the accountability levels that they apply. Introducing a requirement to report the methodologies they employ or any changes to accountability levels would be onerous if conducted on a 'regular basis'. In addition, CMCE does not believe that reporting on the application of accountability levels in practice through annual reports would enhance supervision.
Question 20
In your view, what other types of position management controls could be further specified in the draft RTS?
CMCE answer
CMCE has no further suggestions for position management controls that would need to be further specified in the draft RTS.