Date: 2 September 2020
ESMA70-155-1056

OPINION on position limits on Fish Pool Farmed Salmon contract

I. Introduction and legal basis

1. On 20 December 2017, the European Securities and Markets Authority ("ESMA") received a notification from the Norwegian Finanstilsynet ("Finanstillsynet") under Article 57(5) of Directive 2014/65/EU on markets in financial instruments[1] ("MiFID II") regarding the exact position limits Finanstilsynet intends to set for the Farmed Salmon commodity contract in accordance with the methodology for calculation established in Commission Delegated Regulation (EU) 2017/591 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the application of position limits in commodity derivatives[2] ("RTS 21") and taking into account the factors referred to in Article 57(3) of MiFID II. MiFIR entered into force in Norway on 3 December 2019. Additional information was received on 22 April 2020.

2. ESMA's competence to deliver an opinion is based on Article 57(5) of MiFID II. In accordance with Article 44(1) of Regulation (EU) 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority)[3] ("ESMA Regulation"), the Board of Supervisors has adopted this opinion.

II. Contract classification

Commodity base product: agricultural (AGRI)[4]

Commodity sub product: seafood (SEAF)

Commodity further sub product: not available (NA)

Name of trading venue: FISH POOL ASA

MIC: FISH

Venue product code: FPSA

[1] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349).
[2] Commission Delegated Regulation (EU) 2017/591 of 1.12.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the application of position limits commodity derivatives (OJ L 87, 31.3.2017, p. 479).
[3] Regulation (EU) 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15. 12.2010, p84).
[4] The Farmed Salmon contract has been classified as an agricultural contract for the purpose of this position limit notification.

III. Market description

Supply of salmon:

3. The production of farmed Atlantic salmon takes place in pens along the coastline of Norway, Chile, Scotland, Faroe Islands, Ireland and Canada. Norway is by far the largest producer with more than twice the production of the second largest country, Chile. The production of salmon including harvest volume is only restricted by the number of production permits in each salmon producing country.

4. The global farmed salmon production is more than 2 million tonnes per year. In order to gain a control over the production, one would have to purchase fish farming companies that own substantial parts of the production permits. Also, bearing in mind the lifecycle of salmon production fish farming companies would have to plan at least two years in advance in order to constrain the availability of salmon. Salmon harvested too early is not large enough for the processing industry, while salmon harvested too late is too large and more exposed to diseases. If one wants to limit availability in a period, this must be planned from before the smolt (baby salmon) are hatched.

Transportation and delivery of Atlantic salmon:

5. Salmon is exported throughout the globe by truck, airplane or by container ships. There are a vast number of receiving companies around the world. Most purchasers of salmon are still in Europe or in the United States. A purchaser of salmon can purchase a full load (one truck or one container) or a part load. There is no storage of fresh Atlantic salmon. Warehousing is therefore not used and is not an issue in this market. The logistics are also well-developed and it is easy to deliver the exact number of boxes to each customer. There are no capacity constraints of a delivery point in the salmon market.

Market participants, including structure, organisation and the operation of the market

6. The international farmed salmon market has a large number of market participants; producers (fish farming companies), exporters, processors and retailers selling salmon to the end consumer. The market participants are separated in two main groups:

    - The producers of salmon, fish farmers;
    - Those earning a margin from exporting/importing, processing or selling the product to processors/consumers.

7. Fish farmers produce the salmon and export the commodity themselves or through an independent exporter. Most salmon is sold “head on gutted” and later on processed to a consumer ready product outside the country where the salmon was farmed. Some companies are vertically integrated with an organization supporting all parts of the value chain.

8. Regarding seasonality in the farmed salmon market the volume tends to increase gradually throughout the year due to biologically factors such as water temperature and hours of daylight.

9. The salmon market is an international market and is influenced by currency fluctuations. The market is especially influenced by the currency development of EURNOK and USDEUR.

10. The lifecycle of salmon begins in fresh water. When the small fish has reached at least 60 grams it is ready for saltwater. This takes about one year. Some fish farmers keep the salmon on shore for a longer period to limit the time in sea. After about one and a half year in the sea, the salmon is 4.5 to 5.5 kg and ready to be harvested, sold, exported and processed.

11. When a salmon is harvested, it is characterised by size and divided in three different quality categories: superior, ordinary and production. Size 3-6 kg of superior quality, head on gutted, is the main product.

<u>Salmon derivative market</u>

12. Salmon derivative contracts listed on Fish Pool ASA are financially settled contracts with the Fish Pool Index as reference price. The Fish Pool Index represents the weekly spot price for fresh Atlantic superior salmon, head on gutted ("HOG"), 3-6kg.

13. The underlying commodity qualifies as food for human consumption

14. The derivative contracts are monthly contracts with up to 36 monthly contracts available for trading, i.e. maximum maturity is 3 years. Trading in the contract takes place in lots where one lot equals 1 Metric Tonne (MT).

15. The market participants in the salmon derivative market are mainly European fundamental players, such as fish farmers, fish exporters and processors. The salmon market is an international market and is influenced by currency fluctuations.

16. The volatility observed in the salmon future contract is lower in the short end of the forward curve to the one observed in other commodity markets (e.g. freight, power). The volatility observed in the long end of the forward curve is similar to the one observed in other commodity markets.

17. There is significant open interest in Farmed salmon economically equivalent OTC contracts.

IV. Proposed limit and rationale

Spot month position limit

<u>Deliverable supply</u>

18. Deliverable supply amounts to 93,886 lots, i.e. to 93,886 MT.

19. The Norwegian Seafood Council (NSC) has been used as a data source when calculating the deliverable supply[5].

20. NSC is a public company owned by the Ministry of Trade, Industry and Fisheries. The Council also acts as an advisor for the Ministry of Trade, Industry and Fisheries in affairs concerning seafood export and trade. The data used to calculate the deliverable supply is the export volume of salmon produced in Norway for 2016, converted to whole fish equivalent ("wfe"). 1 ton of whole fish equivalent is the same as 1 ton of whole salmon. According to NSC the total export of Norwegian salmon in 2016 was 1,126,627 metric tonnes (mt) per year which equals to 93,886 mt per month (annual figure divided by 12). Each lot is 1 mt according to the contract specification, therefore the deliverable supply equals 93 886 lots.

Spot month position limit

21. The spot month limit is 23,400 lots, which represents 24,9% of the deliverable supply.

Spot month position limit rationale

22. The baseline for the spot month has been set at 25% of deliverable supply as required by Article 9(1) of RTS 21. The Farmed Salmon contract is related to food intended for human consumption, however, since the open interest is below 50,000 lots (Article 9(4) of RTS 21), the lower baseline of 20% is not applicable to this contract.

23. The contract can have a position limit between 5%-50% as set out in Article 19(2) of RTS 21 as the number of investment firms acting as market makers in accordance with Article 4(1)(7) of Directive 2014/65/EU in the commodity derivative at the time of the position limit is set is lower than three.

24. When considering the volatility in the contract, as required by Article 21 of RTS 21, Finanstilsynet has not found evidence that this is excessive or that lower position limits would reduce volatility.

25. All other factors have been considered and are not regarded by Finanstilsynet as material or relevant to require any additional adjustments, either up or down, from the baseline.

26. Therefore, Finanstilsynet did not make any adjustment to the baseline of 25% of the deliverable supply. This provide a figure of 23,472 lots which has been rounded down to 23,400 lots. This constitutes a final limit of 24.9% of the deliverable supply.

[5] NSC Data: http://seafood.no/globalassets/markedsinnsikt/rapporter/desember-2016-med-arstall.pdf

Other months' position limit

<u>Open interest</u>

27. The open interest amounts to 41,649 lots.

28. The open interest has been calculated from data reported by the trading venue and is the daily average of the absolute amount of all market participants' open long or short futures positions which has not been closed out or expired. The period used is the period from July 2016 to June 2017. The open interest is calculated in lots where one lot equals one metric tonne.

<u>Other months' position limit</u>

29. The other months limit amounts to 20,800 lots, which represents 49,9% of the total open interest.

<u>Other months' position limit rationale</u>

30. Under Article 11 of RTS 21, the baseline figure for the other months' limit is set at 25% of the open interest.

31. The Farmed Salmon contract can have a position limit between 5%-50% as set out in RTS 21 Article 19(2) as the number of investment firms acting as market makers in accordance with Article 4(1)(7) of Directive 2014/65/EU in the commodity derivative at the time of the position limit is set is lower than three.

32. Finanstilsynet made an upward adjustment of 10 percentage points under Article 18(3) of RTS 21, as the open interest is significantly lower than the deliverable supply.

33. Finanstilsynet made an additional upward adjustment of 15 percentage points under Articles 19(2) and 20(2)(d) of RTS 21 in order to avoid the risk of unduly constraining trading in this relatively less liquid commodity derivative market and preventing it from working adequately, considering the need for commercial users in the underlying market to find a counterparty to their transactions.

34. When considering the volatility in the contract, as required by Article 21 of RTS 21, Finanstilsynet has not found evidence that this is excessive or that lower position limits would reduce volatility.

35. All other factors have been considered and are not regarded by the Finanstilsynet as material or relevant to require any additional adjustments, either up or down, from the baseline.

36. Based on the above, Finanstilsynet made an upward adjustment of 25 percentage points to the baseline figure. A 50% other months' limit provides a figure of 20,825 lots which has been

rounded down to 20,800 lots. This constitute a final other months' limit of 49.9% of the open interest.

V. ESMA's Assessment

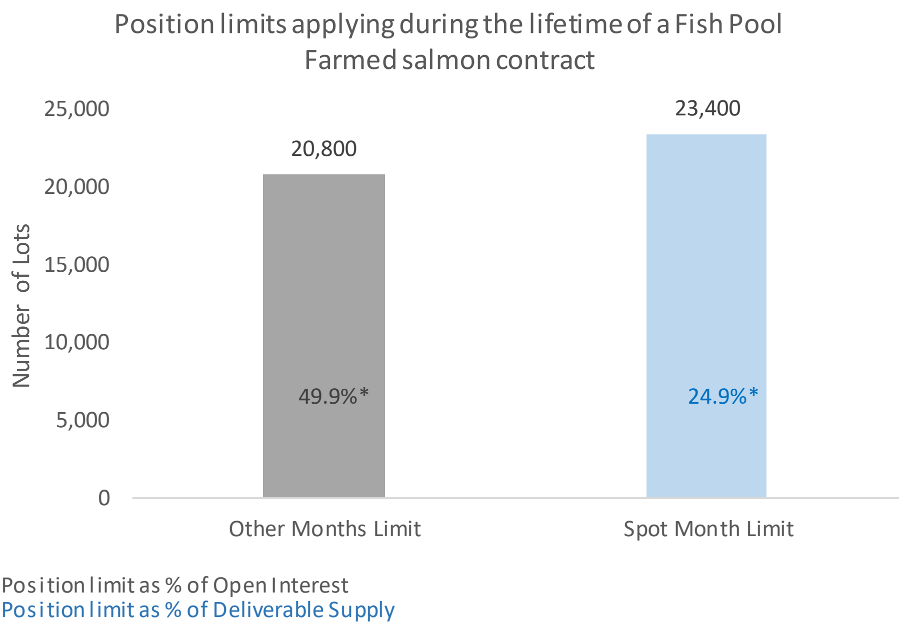
37. This Opinion concerns positions held in Farmed Salmon contracts.

38. ESMA has performed the assessment based on the information provided by Finanstilsynet.

39. For the purposes of this Opinion, ESMA has assessed the compatibility of the intended position limits with the objectives of Article 57(1) of MiFID II and with the methodology for calculation of position limits established in RTS 21, in accordance with Article 57(3) of MiFID II.

Compatibility with the methodology for calculation of position limits established in RTS 21 in accordance with Article 57(3) of MiFID II

40. Finanstilsynet has set one position limit for the spot month and one position limit for the other months.



Spot month position limit

41. The calculation of the deliverable supply is based on average monthly data of export volume of salmon produced in Norway over 2016. This approach is consistent with Art. 10(2) of RTS 21 which reads: "Competent authorities shall determine the deliverable supply (…) by

reference to the average monthly amount of the underlying commodity available for delivery over the one-year period immediately preceding the determination".

42. Although Farmed Salmon is an underlying that qualifies as food intended for human consumption, ESMA agrees that the baseline figure for the spot month limit amounts to 25% of deliverable supply due to the size of the open interest.

43. Based on the characteristics of the contract, ESMA considers it a reasonable approach not to have made adjustments to the baseline figure.

Other months' position limits

44. The open interest was calculated as the daily average of the absolute amount of all market participants' open long or short futures positions which has not been closed out or expired from July 2016 to June 2017.

45. ESMA considers such an approach sensible as an average for a period of time gives a more stable measure of open interest and considers such approach consistent with Article 12 of RTS 21.

46. The baseline figure for the other months' limit amounts to 25% of open interest.

47. The other months' limit has been adjusted upwards to take into consideration the fact that the open interest is significantly lower than the deliverable supply This is consistent with Article 18(3) of RTS 21.

48. The other month's limit has also been adjusted upwards to cater for the positions held by underlying market participants in the relatively low liquidity Farmed Salmon contract and help ensure that commercial users do find a counterparty to their transactions. This upward adjustment appears consistent with Article 20(2)(d) of RTS 21 and the additional upward flexibility provided by Article 19(2) of RTS 21 as the number of market makers is lower than three.

49. Consequently, these position limits have been set following the methodology established by RTS 21.

Compatibility with the objectives of Article 57(1) of MiFID II

50. Under Article 57(1) of MiFID II, the objectives of the position limits are to prevent market abuse and support orderly pricing and settlement conditions including preventing market distorting positions.

51. With respect to the spot month limit, ESMA notes, based on the information provided by the competent authority, that the limit is substantially higher than open interest in the spot month in the period considered.

52. ESMA understands the need to avoid the risk of unduly constraining trading in this commodity derivative market where underlying market participants have a key presence. However, there is a risk that the objectives set out in Article 57(1) of MiFID II may not be achieved where the limit set for the spot month is well above the positions held by market participants in the spot month

53. In light of the assessment above, ESMA considers that the position limit set for the spot month and the other months, overall appear to achieve a reasonable balance between the need to prevent market abuse and to ensure an orderly market and orderly settlement while ensuring that the development of commercial activities in the underlying commodity market and the liquidity of the Farmed Salmon contract are not hampered.

54. However, to help ensure that the risk of not achieving the objectives set out in Article 57(1) of MiFID II does not materialise, ESMA considers that trading patterns in the Farmed Salmon contract should be carefully monitored by the competent authority, in particular during the spot month, and that the spot month limit should be reviewed on a timely basis.

VI. Conclusion

55. Based on all the considerations and analysis presented above, it is ESMA's opinion that the spot month position limit does comply with the methodology established in RTS 21 and is consistent with the objectives of Article 57 of MiFID II. The other months' position limit does also comply with the methodology established in RTS 21 and is consistent with the objectives of Article 57 of MiFID II.

Done at Paris, 2 September 2020

Steven Maijoor

Chair

For the Board of Supervisors