European Securities and Markets Authority

Date: 23 October 2017
ESMA70-155-2288

OPINION on position limits on ICE White Sugar contracts

I. Introduction and legal basis

1. On 7 August 2017, the European Securities and Markets Authority ("ESMA") received a notification from the Financial Conduct Authority (FCA) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments[1] ("MiFID II") regarding the exact position limits the FCA intends to set for the White sugar futures and options 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. This notification was supplemented by additional data provided on 6 October 2017.

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)

Commodity sub product: softs (SOFTS)

Commodity further sub product: white sugar (WHSG)

Name of trading venue: ICE FUTURES EUROPE- Agricultural products division

MIC: IFLX

Venue product code: W

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[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 December 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, p.84).

III. Market description

3. Sugar is produced in more than 120 countries worldwide with annual production around 165-170 million tonnes. Approximately 80% is produced from sugar cane, which is largely grown in tropical countries. The remaining 20% is produced from sugar beet, which is grown mostly in the temperate zones of the northern hemisphere.

4. According to the World Bank, the main importers of sugar are China, Indonesia and the EU with the largest producers being Brazil, India and the EU in 2016.[4] []

5. The 10 largest sugar producing nations represent roughly 75% of world sugar production. Brazil alone accounts for almost 25% of world production. Following behind are India, EU-28, Thailand and China. Sugar is traded both as raw sugar and white sugar. For a long time, the EU was the sole sizeable white sugar supplier, with a market share of 50% in the 1980s. Since then, new refineries for raw sugar have been built at destination locations (e.g. Dubai, Yemen, Syria, Bahrain), displacing a part of white sugar trading in favour of raw sugar.

6. The underlying commodity of the ICE White Sugar Futures contract qualifies as food intended for human consumption.

7. Expiry months for the ICE White Sugar Futures contract are March, May, August, October, December. Eight delivery months are available for trading. The contract trades in lots and one lot is equivalent to 50 metric tonnes. The contract is physically settled.

8. ICE White Sugar Option contracts expire on the first business day of the calendar month preceding the expiry month. The exercise of options results in the assignment of future contracts at the exercise price, i.e. at the strike price

9. It is possible to deliver the contract with white sugar that is produced from white beet, cane crystal sugar or refined sugar of the crop current at the time of delivery. White sugar is acceptable from any origin provided it meets a number of technical specifications at the time it is delivered.

10. The white sugar traded under ICE contracts can be delivered to 94 ports in 43 countries spread across Asia, Europe and North and South America. The delivery ports are representative of global refining and beet processing capacity, aligned with common shipping routes to allow easy access to the commodity.

11. The design of ICE White Sugar Futures Contract reflects the common format of the physical sugar trade and widespread production practices. It is delivered Free on Board (FOB) contract which means ownership of the sugar is transferred when the sugar is delivered free on board the chosen transportation. Contract and settlement procedures incorporate the Refined Sugar Association trading rules.

4 Source: World Bank, Commodity Market Outlook, January 2017

12. ICE Europe is the main exchange on which global white sugar trading takes place. It is actively traded by the international sugar trade, sugar millers, refiners, and end-users (manufacturers) as well as by managed funds and both institutional and short-term investors. There are 118 market participants and one market maker.

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

13. Deliverable supply amounts to 94,816 lots. A lot is equivalent to 50 metric tonnes(MT).

14. The FCA has determined the deliverable supply according to the following process.

15. Deliverable supply has been calculated on the basis of annual export data, which represents the amount of the commodity available for delivery against the contract. White sugar is produced from refining beet and cane and the FCA did not find reliable statistics for the industrial capacity of raw sugar and beet processing. Therefore export statistics are used as the closest available estimates of refined production. These will under-estimate production as they do not take into account domestic production used for domestic consumption. However, production for domestic consumption is unlikely to be tendered into the global ICE delivery process and hence be available to be delivered on the expiry of the ICE contract.

16. Refined sugar stocks are not typically held for long periods in production areas or ports. There are no ICE exchange storage arrangements for White Sugar as settlement is delivery onto the buyer's chosen transportation. Stocks held are therefore not included in the calculation of deliverable supply.

17. There is a physically deliverable white sugar contract which is traded on the Zhengzhou Commodity Exchange which has an open interest of approximately twice the quantity of the ICE contract. However it is understood that this contract is traded primarily by domestic Chinese producers and consumers with physical delivery made in China. The FCA does not think it has an influence on the quantity of sugar available for delivery against the ICE contract that is material enough to justify an adjustment to the limit, particularly given that the FCA has not included domestically produced and domestically consumed sugar in the deliverable supply estimate.

18. Annual export data for 2010-2015 was sourced by the trading venue from the International Sugar Organisation and a 3-year average for October 2013/ September 2014 – October 2015/September 2016 was provided. No data is not yet available for the full year of 2016. The International Sugar Organization reports the volume of world sugar trade at 56 million tonnes a year, of which refined white sugar is a part. Based on the data provided by the International Sugar Organisation, the amount of annual exports of white sugar over the reference period has been calculated to be 23.7 million tonnes per year.

19. For any individual sugar delivery month, deliverable supply has been calculated from the amount of average annual global white sugar exports, representing the sugar available for delivery against the contract, divided by 5 for each of the sugar delivery months (March, May, August, October, December).

20. Deliverable supply for white sugar is the annual average export figure of 23,704,000 MT divided by 5 equating to 4,740,800 MT or 94,816 lots (at 50MT per lot).

<u>Spot month position limit</u>

21. The spot month limit amounts to 18,950 lots, i.e. 20% of deliverable supply. The spot month is the period until the expiry of the next contract to expire. It does not necessarily include a set number of days. The spot month limit applies to the ICE White Sugar Futures and Options contracts.

<u>Spot month limit rationale</u>

22. The FCA has set the baseline for the spot month at 20% as required by Article 9(4) of RTS 21 as this is a contract for food intended for human consumption with an open interest of more than 50,000 lots.

23. Although sugar is a perishable foodstuff, the FCA did not make any adjustment under Article 20(2)(a) of RTS 21on the characteristics of the commodity as quantities of stocks have not been included in the calculation of deliverable supply.

24. The sugar trade can be affected by weather conditions but the FCA does not consider this justifies an adjustment to the position limit on the basis of current evidence.

25. All other factors have been considered by the FCA and are not regarded as material or relevant to require adjustments, either up or down, from the baseline. In considering the volatility in the contract, as required by Article 21 of RTS 21, there has been some variation in the price of the commodity derivative but the FCA has not found evidence that this is excessive or that lower position limits would reduce volatility.

26. As no adjustments were made to the baseline of 20%, this provides a figure in lots of 18,963 which has been rounded down to a figure of 18,950 lots. This equates to a final limit as a percentage of deliverable supply of 20%.

Other months' position limit

<u>Open interest</u>

27. The open interest amounts to 93,202 lots. The open interest figure has been reported by the trading venue and is calculated as the daily average over a one-year period of the number of open futures and delta-adjusted options contracts that have not been closed out or expired. The reference period is calendar year 2016.

Other months' position limit

28. The other months limit amounts to 23,300 of lots, i.e. at 25% of open interest. The other months' limit applies to ICE White Sugar Futures and Options contracts.

Other months' position limit rationale

29. The baseline for the other months has been set at 25% of open interest as required by Article 11 of RTS 21.

30. The sugar trade can be affected by weather conditions but the FCA does not consider this justifies an adjustment to the position limit on the basis of available current evidence.

31. All other adjustment factors have been considered by the FCA and are not regarded as material or relevant to require adjustments, either up or down, from the baseline. In considering the volatility in the contract, as required by Article 21 of RTS 21, there has been some variation in the price of the commodity derivative but the FCA has not found evidence that this is excessive or that lower position limits would reduce volatility.

32. As no adjustments were made to the baseline of 25%, this provides a figure in lots of 23,301 which has been rounded down to a figure of 23,300 lots. This equates to a final limit as a percentage of open interest of 25%.

V. ESMA's Assessment

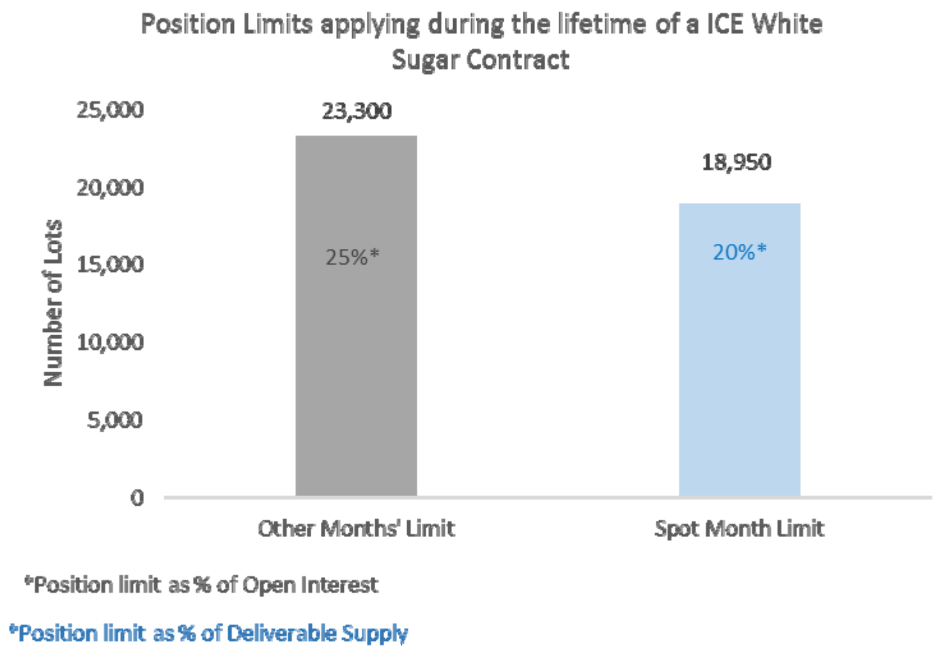
33. This Opinion concerns positions held in ICE White Sugar Futures and Options contracts.

34. ESMA has performed the assessment based on the information provided by the FCA.

35. 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

36. The FCA as set a single position limit for the whole spot month and a single position limit for the other months.



<u>Spot month position limit</u>

37. The calculation of the deliverable supply is based on average export data over the last three years ending 2015/2016 as data is not yet available for 2016/2017. In the absence of reliable white sugar production data, export data appears as a reasonable alternative for the calculation of deliverable supply. As five expiries are traded each year, the annual available deliverable supply has been divided by five. This approach is consistent with Article 10(2) of RTS 21, which sets out that “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”.

38. Compared to the baseline figure of 20% for derivative contracts with an underlying that qualifies as food intended for human consumption with a total interest in spot and other months’ contract exceeding 50,000 lots, the position limit has not been adjusted.

39. ESMA notes that the ICE White Sugar contract is traded on a global basis and agree that the position limit should be set alongside comparable UK global contracts, taking into account the market characteristics of those contracts. In particular, ESMA agrees that compared to other globally traded UK commodity derivative contracts, the number of market participants (116) does not appear high and consequently does not requires no downward adjustment under Article 19(1) of RTS 21.

40. ESMA also considers it a reasonable approach not to have adjusted the position limit downwards based on sugar perishability, as stock data was not included in the estimates of deliverable supply.

41. ESMA also highlights that, in addition to the spot month limit set by the FCA, ICE has delivery limits that apply in the period immediately prior to the expiry of the contract. Currently, ICE delivery limit for the ICE White Sugar and Containerised White Sugar contracts (in aggregate) is set at 10,000 lots and applies at the close of business on the expiry day of the delivery month. This limit of 10,000 lots will be part of the position management powers of the trading venue. ESMA notes that the ICE delivery limit is lower than the spot month position limit of 18,500 lots set by the FCA for the ICE White Sugar only. The reason for this is that the spot month limit applies to the whole of the spot month while the trading venue expiry limit applies only to the period immediately prior to the expiry of the contract. The two limits are complementary and will work together without duplication to ensure orderly trading and settlement. The FCA has decided not to duplicate the existing venue delivery limit controls where these are believed to be established and effective as the objective of the delivery limit of the trading venue is only to manage the physical delivery process and to ensure that market participants meet their delivery commitments. The spot month limit is set by the FCA at a level to support orderly pricing, and enable price discovery, as well as ensure a smooth transition of positions from the other months period to the spot month period.

Other months' position limits

42. The open open interest was calculated as the daily average over a one-year period of the number of open contracts that have not been closed out or expired. The period used is the calendar year 2016. ESMA considers such an approach sensible in this case 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.

43. Compared to the baseline figure of 25%, the position limit has not been adjusted. as none of the adjustment factors listed in RTS 21 was regarded as relevant or material by the FCA. As for the spot month limit, ESMA notes at the ICE White Sugar contract is traded on a global basis and agree that the position limit should be set alongside comparable UK global contracts, taking into account the market characteristics of those contracts. In particular, ESMA agrees that compared to other globally traded UK commodity derivative contracts, the number of market participants (116) does not appear high and consequently does not requires no downward adjustment under Article 19(1) of RTS 21.

44. 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

45. ESMA has found no evidence indicating that the proposed position limits are not consistent with the objectives of preventing market abuse and supporting orderly pricing and settlement conditions established in Article 57(1) of MiFID II.

46. Overall, the position limit set for the spot month and the other months, in conjunction with the position management powers of the trading venue, appear to achieve a reasonable

balance between the need to prevent market abuse and to ensure orderly pricing and orderly settlement, while also ensuring that the development of commercial activities in the underlying white sugar market and the liquidity of the ICE White Sugar futures and options contracts are not hampered.

VI. Conclusion

47. 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, whenever applicable, does comply with the methodology established in RTS 21 and is consistent with the objectives of Article 57 of MiFID II.

Done at Paris, 23 October 2017

Steven Maijoor

Chair

For the Board of Supervisors