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| Reply Form to the Call for Evidence |
| Position limits and position management in commodity derivatives |

**Responding to this paper**

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

* respond to the question stated;
* indicate the specific question to which the comment relates;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

ESMA will consider all comments received by **5 July 2019.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’. Please follow the instructions given in the document ‘Reply form for the call for evidence on position limits and position management controls in commodity derivatives’ also published on the ESMA website.

**Instructions**

In order to facilitate analysis of responses to the Call for Evidence, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Call for Evidence in the present response form.
2. Please do not remove tags of the type <ESMA\_QUESTION\_PLPM\_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA\_PLPM\_nameofrespondent\_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA\_PLPM\_ABCD\_RESPONSEFORM.
5. Upload the form containing your responses, in Word format, to ESMA’s website ([www.esma.europa.eu](http://www.esma.europa.eu) under the heading “Your input – Open consultations” 🡪 “Call for Evidence on Position limits and position management in commodities derivatives”).

**Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

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**Who should read this paper**

All interested stakeholders are invited to respond to this consultation paper. This consultation paper is primarily of interest to trading venues, investment firms and non-financial counterparties trading in commodity derivatives, but responses are also sought from any other market participant including trade associations, industry bodies and investors.

**General information about respondent**

|  |  |
| --- | --- |
| Name of the company / organisation | Deutsche Börse Group |
| Activity | Regulated markets/Exchanges/Trading Systems |
| Are you representing an association? |  |
| Country/Region | Germany |

**Introduction**

***Please make your introductory comments below, if any***

<ESMA\_COMMENT\_PLPM\_1>

Deutsche Börse Group (DBG) appreciates the opportunity to respond to ESMA’s Call for Evidence on position limits and position management in commodity derivatives and to share our observations. DBG welcomes that the survey is wide in scope, enters into a great level of detail and touches upon the most critical elements of the position limits regime.

Considering the important impact the MiFID II position limit regime has on DBG, especially on products traded on our entities European Energy Exchange Group (EEX Group) and Eurex Frankfurt AG (Eurex), we have tried to answer as detailed as possible. However, we remain at the disposal of ESMA for any questions or further information.

Eurex is a derivatives market operator within DBG, offering inter alia broad-based commodity index derivatives, and EEX Group is the commodity branch of DBG, comprising markets for energy, agriculture, freight, metals and environmentals.

Looking at the history of the MiFID II position limits regime and the fact that the regime needed to be built up from scratch, we recognise the great efforts that ESMA and National Competent Authorities (NCAs) have put into its implementation. We appreciate the open dialogue we have had in the past and commit to taking a thorough look at all of its aspects, exploring potential improvements for all parties concerned.

Also considering the limited amount of data available at the start of the position limits regime, we acknowledge that the regime has worked well for the highly developed contracts, which are characterized by a large number of different types of active trading firms and an overall substantial amount of open interest, and hence did not have a detrimental impact on volumes for such contracts.

However, **for the development of new products and growth of existing illiquid or less liquid commodity derivative markets, the position limits regime has proven to have substantial impact**, meaning that we have observed a stagnation in markets of which we believe they would have been more liquid in the absence of position limits.

In this context, in particular, fast growing markets have suffered from an increasingly restrictive standard limit of 2,500 lots when contracts come close to 10,000 lots of open interest. The second most important issue we experienced is the lack of flexibility in the rules for regulators to deal with special circumstances (e.g. by for example using a more forward-looking approach in the calculation of open interest used as a baseline for setting position limits).

Moreover, during the legislative and regulatory process of MiFID II / MiFIR, we shared our perspective and understanding, especially in light of the scope of the position limits regime. While it is acknowledged that the legislators’ objectives have been to address certain phenomena in the commodities derivatives market, and to introduce certain measures, we would like to reiterate our understanding that **cash-settled derivatives on broad-based indexes composed of commodities related components should not be included in the scope of the regime**. In the past, we have provided our reasoning for the mis-attribution of scope, and currently, we can share also evidence of the impact on this market and unintended consequences in the development of transparent markets and a healthy ecosystem with a heterogeneous market participant pool.

In this respect, we strongly recommend re-focusing the application of the regime to fit the legislative objective, in order to address the unintended consequence identified, especially in cash-settled commodities derivatives contracts on broad-based index underlyings, as well as the lack of global rule harmonization and trading needs and standards.

Considering the limited contribution that the MiFID II position limits regime has on orderly pricing and orderly settlement as well as on prevention of market abuse, we believe the **objective of this review should be to have** **a more proportionate and efficient regime. This can be achieved by focusing the application of the MiFID II position limits regime on a selected set of important, critical (benchmark) commodity derivative contracts.** Such a refocus of the position limit regime on benchmark contracts would make it more efficient, mitigate the unintended consequences and reduce the compliance burden for all concerned parties (market participants, trading venues, NCAs/ESMA).

Most importantly, such a targeted approach would allow new and nascent products to develop, in line with the policy objective of the Directive as expressed in its implementing RTS 21:

*“Position limits should not create barriers to the development of new commodity derivatives and should not prevent less liquid sections of the commodity derivative markets from working adequately“.*

Secondly, at the same time, we believe that such an amendment would better fulfil the overall objective of MiFID II to “*improve the functioning and transparency of commodity markets and address excessive commodity price volatility*”.

Thirdly, a more proportionate and efficient regime would contribute to the European Commission’s objective to strengthen the competitiveness of European commodity derivatives markets in context of the international role of the Euro.

A refocus of the systems is justified as the price formation mainly occurs in mature products which serve as benchmarks for the respective market. New and nascent products constitute a minor share of commodity markets. Such contracts are unlikely to influence price movements in the underlying physical commodity markets and thus do not negatively impact consumers.

The other (non-significant) contracts would remain subject to the position reporting regime under MiFID II Art. 58, the pre-existing position monitoring and position management measures by exchanges and the market oversight practices of the exchanges’ market supervision and market surveillance departments that apply the principles laid down in the Regulation on Energy Markets Integrity and Transparency (REMIT) and the Market Abuse Regulation (MAR). Thus, removing position limits for such contracts would not pose any risk to the transparency and functioning of the respective markets. On the contrary, attracting more volume to regulated venues would contribute to a more transparent trading environment.

Instead of or in addition to limiting the scope of the position limits regime, another approach would be to review the position limits regime in view of making it more flexible, not only for NCAs to deal with special circumstances such as index transfers and bidding zone splits, but also for NCAs to deal with a breach of the position limit in general. So far the majority of breaches of EEX Group position limits were related to errors in position reporting, the lack of a hedging exemption or the lack of a liquidity provision exemption. We believe that there is merit for the position limits regime to function as a warning system that alert NCAs whenever there is a breach so that NCAs can start to investigate whether there is an actual risk of market abuse. In the case of gas and power derivatives, it could be the responsibility of the NCA to forward the case to the Agency of Cooperation of Energy Regulators (ACER) whose main task is to prevent market abuse.

<ESMA\_COMMENT\_PLPM\_1>

**Questions**

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

<ESMA\_QUESTION\_PLPM\_1>

**I. The regime’s shortcomings to the development of new, illiquid and less liquid contracts:**

As highlighted in the introductory comments, the MiFID II position limit regime has so far been able to function in a reasonable manner for several well-developed benchmark contracts. For the development of new contracts and the growth of existing illiquid commodities derivative markets as well as the functioning of liquid markets we have identified several shortcomings of the current regime.

In our view, the most significant impact has been on new, illiquid and less liquid contracts, meaning contracts between 0 and 20,000 lots open interest. The position limits constituted a major obstacle to the development of new and illiquid contracts in both freight and gas future contracts, and to a lesser extent to the development of less liquid contracts in power contracts.

The main factors driving this development according to asset class:

*Dry bulk freight:*

Background: Since 2015, European Commodities Clearing (ECC), the clearing house of EEX Group, is offering clearing services for EEX futures on dry bulk freight. The introduction followed EEX’s cooperation with the Singapore-based Cleartrade Exchange Pte Ltd (CLTX) which now operates under the trading name EEX Asia. Both exchanges, EEX and EEX Asia, offer a trade registration service for cash settled futures in Dry Bulk Freight for the purpose of clearing these transactions with ECC.

EEX lists futures and options contracts on dry bulk freight time charter (Capesize, Panamax, Supramax and Handysize) and futures contracts of dry bulk freight voyages and trips (Capesize and Panamax). In total, the portfolio is comprised of 22 contracts.

Under the MiFID II position limits regime, currently only the Panamax freight future and option contracts are deemed liquid and have a bespoke limit set by the German NCA, i.e. the German Federal Financial Supervisory Authority (BaFin), i.e. 4,049 lots for the spot month contract and 4,049 lots for the other month contract. The remaining freight contracts are deemed illiquid and hence are subject to the de minimis rule and have a position limit of 2,500 lots for both the spot month and other month contract.

The contracts listed at EEX are currently the only dry bulk freight contracts listed in the EU and hence the only dry bulk freight contracts subject to the MiFID II position limits regime. As the dry bulk freight market is a global market, EEX competes directly with the Singapore Exchange (SGX) in Singapore and Nasdaq Futures Exchange (NFX) in the US.

As a result, for some clients the driver to prefer trading outside of Europe has been **the mere existence of a limit**, for other clients **the mere fact they have to go through the hedging exemption application process**, which for other exchanges outside Europe with economically fungible contracts they do not. Additionally, we received a number of complaints from clients that the hedging exemption application process is too complex. First, it would need to require access to the BaFin MVP system. Second, it would need to hand in an application in German, describing its business model. After that it has to await its approval or rejection. As the market is global and many of our clients are international players, they often prefer to trade on NFX or SGX rather than to go through the described application process.

However, the most important reason for position limits having hampered the development of EEX freight contracts, and particularly the Capesize contract, is the fact that **for more critical clients, on which the take-off of the contract is fundamentally dependent, the 2,500 lots limit is too restrictive**, particularly when the contract comes close to 10,000 lots open interest.

Figure 1: Impact of the 2,500 lots limit being too restrictive for EEX Capesize 5TC contract

Another reason for the position limits having hampered the development of EEX freight contracts is **the slow pace with which a contract is classified from illiquid to liquid** and hence, receives a bespoke position limit. See for example figure 2.

The development of the Panamax contract was hampered as the contract moved from the de minimis limit of 2,500 lots to a bespoke limit of 4,049 lots only four months (from mid-April 2018 until end of July 2018) after the contract had exceeded the 10,000 lots liquidity threshold for more than three consecutive months.

Figure 2: Impact of slow pace with which the EEX Panamax 4TC contract is classified from illiquid to liquid

Finally, the development of EEX freight contracts is being hampered by **the lack of flexibility in the rules for NCAs to deal with special circumstances**.

To give an example for our freight contracts: EEX freight contracts are – as all other dry bulk freight contracts that use the Baltic exchange indices – going through the process of transferring to a new index that is more representative of the underlying markets. This means that the market will switch trading over time from one product to the other and that until the market has switched to the next product, the old index contract and the new index contract run in parallel to each other. Technically, the contracts are different contracts, but in effect they are simply a different measurement of the same underlying market.

To illustrate: The differences between the Capesize 4TC and Capesize 5TC are mainly down to two changes:

* Capesize 4TC is the average of a basket of four individual routes whereas the 5TC is the average of basket of five individual routes.
* The 5TC vessel description is slightly different from the 4TC vessel description, i.e. it is a slightly larger vessel.

The changes were made to the index (from 4TC to 5TC) to reflect changes in the physical market with larger vessels becoming more common and trade patterns changing slightly. Therefore, the 5TC is an updated version of the 4TC rather than exactly the same contract, as defined by Art. 5 of Delegated Regulation (EU) 2017/591. Open interest still exists against the 4TC index but the Baltic Exchange does not actually produce the index anymore or a forward curve for the index.

Instead the value of the 4TC index is a fixed differential from the 5TC index, i.e. the 5TC index minus $1,064. Moreover, as the market no longer trades 4TC it is not possible to actually close open 4TC positions. Instead traders simply “close” positions in the 4TC contract by trading 5TC. (The price correlation is now always 100%.) So, liquidity is effectively spread over two contracts, despite the 4TC contract not being traded anymore.

The inability of NCAs to for example consider the 4TC and 5TC as same contracts, has resulted in our largest client in this segment breaching the position limit, our second largest client having temporarily suspended all trading on EEX freight contracts and the remaining clients having stopped trading, as liquidity is unsatisfactory. It is noteworthy that – as for any illiquid contract – the open interest is shared among only a couple of market participants (e.g. 80% of Capesize volume comes from only 6 clients, with two of them having been responsible for more than 50% of all positions). Establishing liquidity in a new product/market always relies on a small number of (large) clients doing the first trades together (if two, ending up with 100% of the net open interest) and by that accumulating certain positions in their portfolio. In order to attract new clients trading in new products/markets – so that the distribution of our volumes is more even across them – we first of all need to show them that the market is growing and attracting liquidity. However, all attempts to establish liquidity in a new and regulated market fail if customers are not able to open an adequate portfolio.

Another hypothetical example where the same flexibility would have been needed to deal with special circumstances can be found with EEX power contracts. The German bidding zone split triggered EEX to split the German/Austrian Phelix benchmark power contract into a German power contract and Austrian power contract. If the EU position limits regime would have already been in place when the situation occurred, then the transition would have been impossible due to the inability of BaFin to consider the contract as the same or set the new limits based on anticipated growth.

*Gas:*

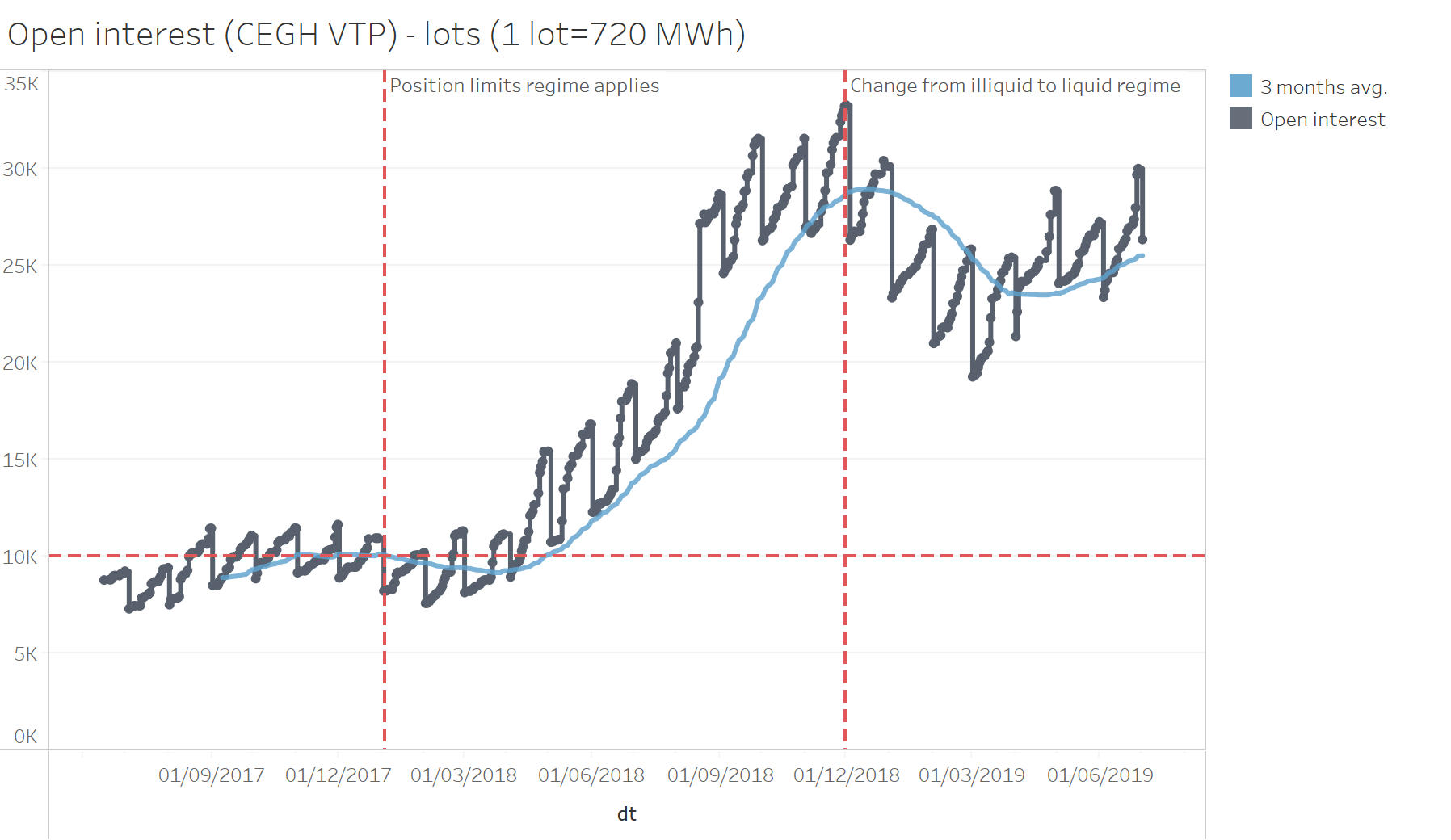
Background: PEGAS is the central gas trading platform of EEX Group operated by Powernext – being the Natural Gas branch of EEX Group. It lists gas derivative contracts in the Austrian, Belgian, Czech, Danish, Dutch, French, German, Italian, Spanish and UK market areas. The gas hubs PEG Nord, TTF, GPL, NCG and PSV are considered liquid and hence have received a bespoke position limit. For most of these markets, Powernext’s main competitor is ICE Endex and ICE Futures Europe.

Also in the gas market the main reason for the position limits having hampered the development of new, illiquid and less liquid contracts is the **de minimis limit of 2,500 lots being too restrictive particularly for contracts close to 10,000 lots open interest**.

This has particularly been the case where:

1. A market has been volatile with a total open interest oscillating between 5,000 and 20,000 lots, leading to periods where the 2500 lots limit represented only 12.5 percent of the open interest. The reason for this is the combination of **the strict definition of a liquid contract** (exceeding 10,000 lots of open interest during three consecutive months) **not being appropriate for contracts that are prone to volatility** and the **slow pace with which contracts are classified from illiquid to liquid and hence receive a bespoke position limit**.

* See figure 3. While there had been no impact the first few months, the open interest started decreasing almost at the same time when the bespoke position limit became applicable.

Figure 3. Impact of strict definition of a liquid contract in combination with the slow pace with which the CEGH VTP contract was classified from illiquid to liquid.

1. Financial entities, though mainly engaging in hedging activities, are unable to benefit from the hedging exemption. In these cases, the 2,500 lots limit hampered the development of the contract.

Figure 4 and 5 illustrate this negative impact of the 2,500 lots limit on PEGAS’ Czech Virtual Trading Point, CZ VTP, and PEGAS’ Zeebrugge Trading Point (ZTP) gas future markets. Both markets took off in the course of 2018, but then declined when the 2,500 lots limit became too restrictive. With only 10 to 12 market participants registered to trading and only 1 or 2 very active market participants being responsible for most of the volumes – an absolutely normal situation for a new contract –, the position limit put a halt to the further development of the contract. While some participants are eligible for the hedging exemption (and applied for one), some important participants are investment firms and cannot benefit from this exemption, meaning that they have no other option that stop trading and look for other hedging alternatives.

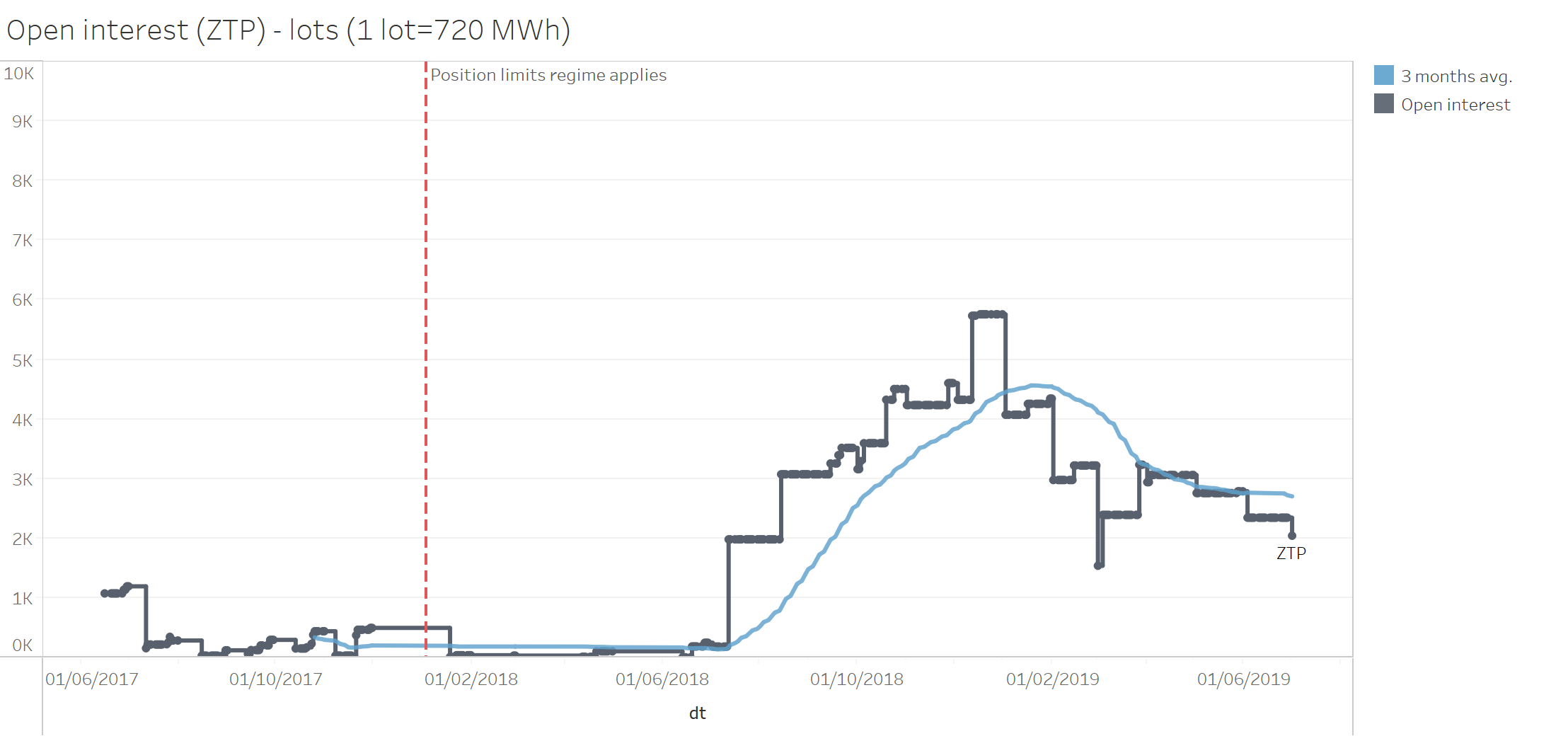


Figure 4. Impact of position limits regime on development of PEGAS ZTP gas futures market.

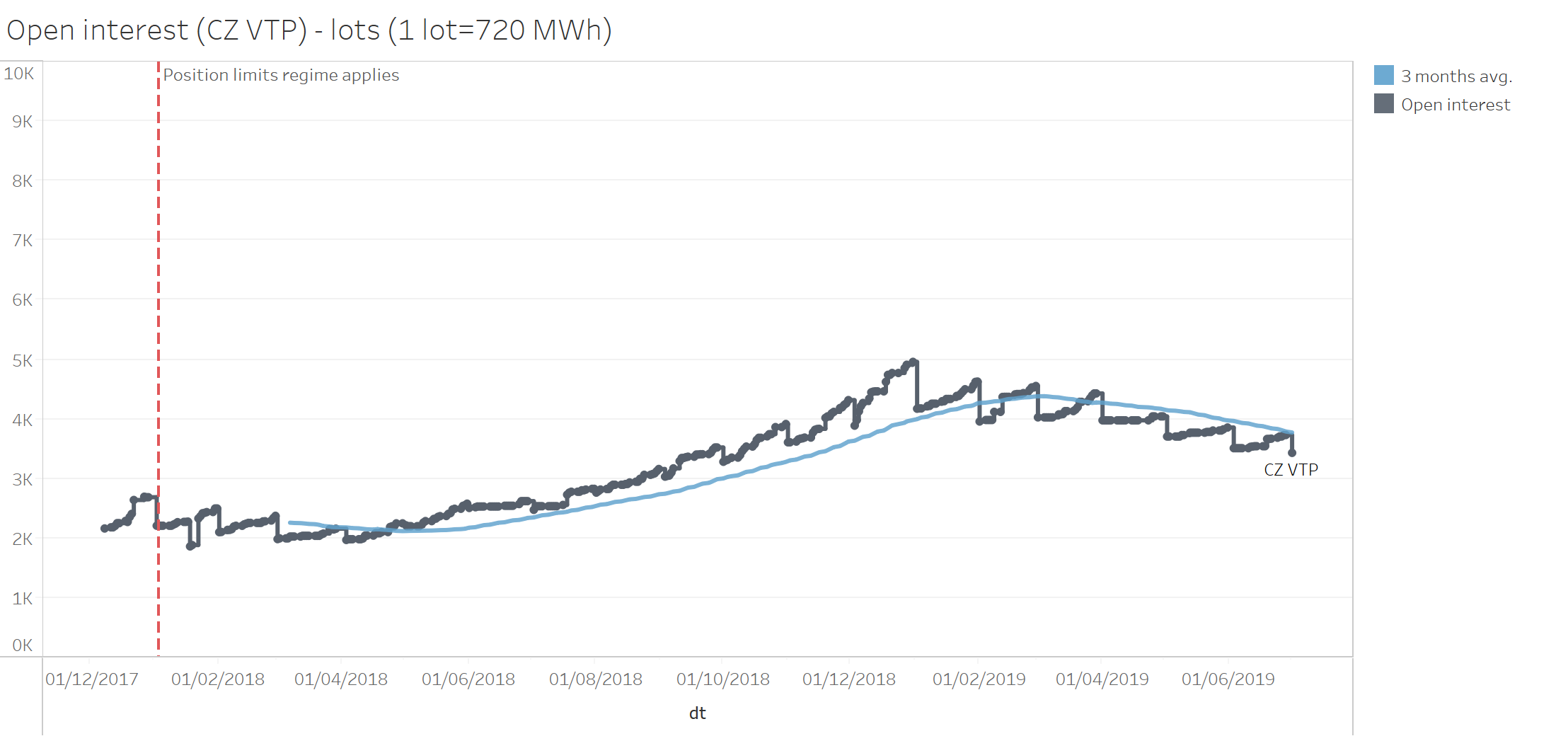


Figure 5. Impact of position limits regime on development of PEGAS Czech VTP gas futures market.

Please see Q16 for more information about this problem.

1. The trading engine being used, uses a different definition of lots. If the definition of lots does not sufficiently follow economic **considerations the limit might be artificially low.**

*Power*:

Background: EEX offers trading in power derivatives for cash-settled futures contracts for 20 European power markets across Europe. Phelix power DE (Base and Peak), Phelix power DE/AT (Base and Peak), Phelix power DE/AT OTF (Base), French power (Base and Peak), Italian power (Base and Peak), Spanish power (Base), Swiss power (Base), PXE Czech (Base) and PXE Hungarian power (Base) are considered liquid and hence have received a bespoke position limit.

In power, there has been no visible impact from the de minimis limit being too restrictive. However, **the development of liquid contracts has to a limited extent been hampered by three elements**: (1) the lack of flexibility in the rules for NCAs to deal with special circumstances, (2) the slow pace with which bespoke limits are set and reviewed, and (3) the relatively complex process to apply for the hedging exemption.

1. **The lack of flexibility in the rules for NCAs to deal with special circumstances***:* At the end of 2017, EEX decided to split its Phelix German/Austrian power benchmark contract into a Phelix German power future and Phelix Austrian power future, due to the underlying bidding zone split. Although it was expected that the liquidity in the Phelix German power future would soon pick up after the product would be launched, the position limits regime does not allow a forward-looking approach to determine the open interest on which the position limit should have been set. As a consequence, BaFin had to review the limit not long after it had set a bespoke limit on the contract.
2. **The slow pace with which bespoke position limits are set and reviewed:**For most of the power contracts that became liquid after MiFID II went live, the time from the contract having exceeded 10,000 lots open interest during three consecutive months to the time a new bespoke limit became applicable, on average took around two to three months. This delay is merely due to the fact that the German law transposing MiFID II (Zweites Finanzmarktnovellierungsgesetz of 23 June 2017 (BGBI. I S. 1693)) lays down that every new position limit requires the adoption of an administrative act, and thus also a public consultation, which in total can easily take several months. Fortunately, due to the quick reaction of BaFin, we were able to cope with the split of the Phelix German/Austrian power future into a Phelix German and Phelix Austrian power future in a relatively smooth manner.
3. **The relatively complex hedging exemption application process:**Lastly, we received a number of complaints from market participants that believed the hedging exemption application process was too complex. For more information see the section on freight.

**II. The regime’s impact on cash settled derivatives on broad-based index underlying:**

In our view, **derivatives on broad-based commodity indexes are wrongly addressed in the scope of the position limits regime**.

It has been experienced that **the regime creates barriers for new client flow and promotes shifts to OTC and puts liquidity providers and market makers into strenuous situations in performing their role – namely, to provide liquidity.** In addition, and as a starting point, **the regime does not adequately address those types of derivatives and does not seem to take into account the already embedded mechanics**. In the following, we would like to elaborate on these facets, first focusing on the observations since the introduction of MiFIR/ MiFID II, and then recapping on the methodology of the particular type of broad based commodities indexes on Eurex and the inadequate deployment of position limits on those types of contracts:

The position limits create **entry barriers for new clients**, as they can only trade the products, if they are (technically) set up for the daily reporting of their positions. Since the new regime is in place, no new clients have started to trade the commodity index products at Eurex. In that sense, the laborious reporting requirements set out in the laws seem disproportionate to the style and purpose of trading these derivatives and the small market demand for a niche purpose does not motivate traders, from various buy-side communities interested into these types of derivatives, to move positions from the OTC market into a listed and cleared exchange environment. Thus, we experience a prohibitively high barrier for small and illiquid markets like on these types of broad based index derivatives tradable on Eurex.

The position limits also create **hurdles for existing clients**: This is in particular true for liquidity providers / market makers, who often trade against separate clients / funds, but while the clients have therefore separate limits, it is all adding up in the same position for the market makers, the more illiquid the market, the higher the straining on the liquidity provider / market maker, as chances are high that only few market makers and few clients interact in illiquid markets. The liquidity provider / market maker will always try to be delta-neutral, i.e. each trade they do in the commodity index futures at Eurex will immediately be offset by a hedge in other products (normally the individual commodity futures in the index). Liquidity providers / market makers make their livings from offering exposure to certain product and earn on the spread, but are risk-avoiders by definition. Therefore, position limits are limiting their ability to offer this important service.

In addition to these concerning developments for the growth of transparent and liquid markets, we would like to further point out that the product design of these derivatives contracts, namely, **broad based commodity index derivatives, should not have been included into the scope of the regime** in the first place:

* Bloomberg Commodity Indices are calculated from futures prices on many single individual commodities and all futures are exchange traded in regulated markets / exchanges even though not all under MiFID legislation. For this reason, several limits are applied on the individual components of the index itself and the calculation of the index ensures that the index reflects a broad range of underlying commodities, i.e. the weighting is very dispersed. This implies, meanwhile, that broad based commodity indices, like the Bloomberg Commodity Indices used as underlying for derivatives at Eurex, cannot be used to speculate or used in a malicious manner by traders by construction.
* First, the broad-based index underlying does not allow to manipulate the underlying market into a direction, as no single component would have the weight to bring market participants into a corner or squeeze situation.
* Secondly, the individual futures components of the index are already receiving position limits in their markets on an individual level. All individual commodity futures used in the underlying of the Bloomberg Commodity Indices used for Eurex derivatives have their own position limits, set by the local regulator / exchange. Therefore, defining them on the index level is rather redundant.
* Thirdly, the derivatives product on the broad-based commodity index tradable on Eurex is cash-settled. As a regulated market, also using the means of position limits for other asset classes, this measure is only deployed to physically-delivered instruments, where it makes sense to deploy such limits – not on cash settled instruments.
* Finally, all trades are published and transactions are reported to regulators by market participants

Taking all these facets together, we conclude that growth in this market is hindered by a second position limit being placed on the broad-based index derivative. This is not understood to be a reasonable measure for increasing market integrity but impairs the growth of and demotivates client flow to be shifted to transparent and electronically traded markets and limits the capability for liquidity providers to follow their role and regulatory requirements, due to the resulting requirements stemming from a mis-categorisation into the scope of the regime.

We acknowledge that regulators and legislators equally might be concerned that exclusion of scope might open opportunity for loopholes. Therefore, we recapped the aforementioned product design of these derivatives contracts, in order to demonstrate that the product construction and specifications already fulfil many of the objectives of the law, to achieve market integrity and transparency, and can be taken into consideration when the definition scope will be revisited.

We would further like to add on an exemplary note the impact on market participants trading the index derivative on Eurex, and the interaction of trading in the single underlying, in order to display how the unintended consequences of redundant position limits challenge the markets participants:

* In Europe, the limits themselves are set in a way that they are reached already with relatively small trades, and do not allow for meaningful trading for market participants in those derivatives, by investing or hedging. Taking the example of a Eurex futures or options contract on a broad-based Bloomberg Commodities Index, the disproportion can be visualized: A limit of 2,500 contracts (as the contract is illiquid) with a typical contract notional of $~20,000 means that already with a trade of $50mn a client can breach the limit. That shows already that the current regime has some flaws when applied to these types of instruments as the limits are defined via number of contracts rather than via notional. It has also the downside, that liquidity is split via different products representing the same underlying market. As the commodity indices are calculated out of many individual commodity futures, a trade of $50mn in the broad index translates into individual trades / hedges of $2.5mn in e.g. Corn Futures or $1.5mn in Silver Futures. The overall open interest in Corn Futures at CBOT is currently at $36bn, this means that with a trade representing 0.01% of the Corn market, someone might already breach the position limit at the contract on Eurex. This is a false depiction of the overall market situation in a global trading setting.

We therefore strongly **recommend** **reconsidering the definition scope, and take into account a framework on a more harmonised basis, like for example globally applied regimes**, e.g. in the US, or at least **take into consideration the aforementioned descriptions and explanations on cash settled derivatives on broad-based index**, to better delineate and calibrate a definition for commodities derivatives that focus on contracts that would be adequately captured by the regime.

<ESMA\_QUESTION\_PLPM\_1>

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

<ESMA\_QUESTION\_PLPM\_2>

From a EEX Group perspective, the most significant structural change is **the move from competing European dry bulk freight contracts and gas contracts outside of Europe**, leading to EEX and Powernext in some cases being the sole operator of these contracts in Europe.

For example, CME Group moved its physically-settled TTF futures contracts, which are in direct competition to futures listed in Europe, from the EU to the US prior to MiFID II. Such third-country trading venues benefit from the fact that position limits do not apply. (Also, volumes traded on such platforms do not count towards the MiFID II Ancillary Activity threshold or to the EMIR threshold (subject to an equivalence decision, which has been taken for CME)). Another example is the Polish power exchange delisting its suite of cash-settled contracts in late 2017 prior to the start of MiFID II.

Furthermore, market participants trading on European exchanges need to comply with the position limit regime, but they do not when trading bilaterally. From a Eurex perspective, **since the introduction of the new MiFID II position limit regime, no new clients have started to use the Eurex derivatives products**. Any interested new client would have to create a link to the Regulatory Reporting Hub of DBG first and establish a daily position reporting process in parallel, in order to satisfy regulatory requirements. This hurdle seems to be too high for derivatives contracts that are used by specialised market participants with particular trading purpose, especially in a market which has traditionally always been OTC and rather tailor-made. Eurex has basically stopped to put much effort into the promotion of the commodity index derivatives products, as the **likelihood of attracting new clients onto a transparent market is just too low based on the existing position limit and reporting regime and the resulting attractiveness of OTC markets** being commonly viewed as cheaper and less burdensome from a regulatory perspective. But beyond the prohibitively high IT investments to satisfy the IT requirements for reporting, often the limits impair the market participants in their trading globally, be it in their role as investors or hedgers from the buy-side community, or as liquidity providers, with additional regulatory requirements, separate from position limits deployment globally. This is unfortunate, as we see in other asset classes a much higher push also by end-clients to move away from the OTC market into a listed environment.

We recommend reconsidering the unintended consequences of limiting a market to shift from OTC to a transparent market and to limit the functioning and roles of trading in derivatives markets.

<ESMA\_QUESTION\_PLPM\_2>

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

<ESMA\_QUESTION\_PLPM\_3>

We do not believe that the position limits have contributed to or improved the prevention of market abuse in commodity derivatives markets.

First of all, ensuring an orderly price formation process is one of the key tasks of an exchange in general and has been achieved already by a broad range of measures, i.e. surveillance and supervision systems as well as position monitoring and management control mechanisms, to avoid that any factors which might impact the price formation process are prevented. Exchanges, their surveillance systems as well as their supervisors work closely together in this context – based on a well-established legal framework.

For example it is the legal responsibility of the EEX and Powernext Market Surveillance Departments to ensure that trading processes and pricing are carried out on a fair and manipulation-free basis. In Germany, the Market Surveillance Department is an independent and autonomous body of the exchange, which is only subject to instructions by the Saxon State Ministry of Economic Affairs, Labor and Transport. The EEX and Powernext market oversight systems, including the compliance, supervision and surveillance activities, are executed in line with both REMIT and MAR, which both apply to gas and power derivative markets. While REMIT introduces a sector-specific legal framework for identifying and penalizing insider trading and market manipulation in wholesale energy markets across Europe, MAR establishes a pan-European regime to prevent and detect market abuse, market manipulation and insider dealing in financial markets, including energy derivative markets. For example, if the EEX Market Surveillance Department has the justified suspicion that an order or transaction violates the provisions of Arts. 3 or 5 of REMIT, it has to inform the national (energy) Market Monitoring Authorities or in case of Art. 14 or 15 of MAR (ban on engaging in or attempting to engage in insider dealing or market manipulation), it shall inform BaFin thereof.

Our market surveillance activities as well as the pre-existing regulations have been effective in preventing market abuse and excessive speculation. One of the reasons is that, for example, to identify and prevent market abuse, the departments monitor trading behaviour in combination with position size, while the position limits regime only monitors position size. Monitoring position size reflects the ambition to limit market power, rather than the ambition to limit market manipulation. As reflected in the application of the hedging exemption, there is no link between a large position and market manipulation. To investigate a potential market abuse, one has to monitor trading activity. Nevertheless, if limiting market power would be the objective of the position limits regime, than it is advisable to set a position limit on the capacity a person can bring on to the market (or withhold from the market) at a specific point in time (and hence set a limit in terms of MW), and not to set a limit on the generation a person can offer to the market over a period of time (as the current limit expressed in MWh).

*Cash-settled contracts:*

Secondly, the misuse of market power can appear only in physically-delivered contracts, where there is a possibility to squeeze or corner the market and/or the underlying physical spot market. EEX Group agricultural and freight products as well as most of EEX Group power contracts are cash-settled (with some of them having the option to be physically delivered). From our point of view as well as many academics’ point of view, it is nearly impossible to misuse market power derived from a substantial position to corner or squeeze the market without physical delivery. Such contracts do not only have the benefit of having a more practical settlement procedure, they are also known to be less susceptible to market power manipulation (such as squeezing and cornering) than physically-settled contracts. This is because in a cash-settled contract the settlement price at expiration is set equal to the value of some reference price or index value. E. g. the EEX Phelix DE power future uses the Physical Electricity Index (Phelix) which refers to the base load and peak load price index published daily on the power spot market for the German/Austrian market areas. Hence, in order to corner or squeeze the market, one has to be able to manipulate the underlying reference price or index. As long as the underlying index is sufficiently robust, which is the case for the freight, power, gas and agricultural products EEX Group offers we do not believe that market squeezes are likely to occur.

From a Eurex perspective, Eurex broad-based Bloomberg Commodities Index Derivatives cannot be considered as liquid (yet), regarding the commodities derivatives position limits regime. Hence, the exchange and its exchange organ – the independent trading surveillance office – have not seen any kind of market abuse so far. In essence, we believe that there is no benefit in setting position limits for cash-settled products, but quite the opposite for physically-delivered products. For physically-delivered products it would be possible to squeeze (corner) a market by holding large long future positions in combination with long positions in the underlying and forcing members that have short positions in futures to pay nearly every price to get out of their obligation to deliver the underlying. Therefore, all other cash-settled products on Eurex are not limited in position, but according to exchange regulations position limits are imposed on physically delivered derivatives contracts in the fixed income futures space, for example, or equity options, and set taking into consideration market characteristic of those markets.

We strongly recommend reconsidering the element of cash-settled products. To our experience, position limits unfold their value for market integrity in physically delivered contracts. The underlying is usually a single instrument or a very narrow defined basket, and not a broad-based index.

*Gas and power contracts:*

The contracts that are almost always physically-delivered are gas contracts. However, both gas and power are goods that are very difficult for a market participant to control. There are a number of reasons for this:

1. Power and gas markets are under strict supervision of national and European regulators. First of all, the gas and electricity system in Europe is a critical infrastructure which is therefore under supervision of various national and European regulatory agencies such as ACER. Moreover, all trading activities in the electricity market need to be reported under REMIT. ACER monitors the functioning of gas and electricity markets in general, and of wholesale energy trading in particular.
2. Gas and power are grid-bound commodities, where delivery takes place through meshed transmission system grids. This means that market participants have no control over the actual destination of the generated power. Additionally, electricity can still only be stored to a very minimal extent, i.e. by means of battery storage. In fact, electricity is still widely seen as a non-storable commodity.
3. The structure of the gas and power markets is highly diverse. There is a high number of market participants in the spot market and their role in the market is very diverse. According to BnetzA data (Feb 2017) there are about 700 companies in Germany holding a license under §5 EnWG to supply electricity to retail clients. Moreover, due to the energy transition diversification is further increasing. Germany and all other European electricity markets are currently in a process of fundamental market design changes (“Energiewende”). At the same time, more and more renewable energy generation facilities and new generation companies are entering into the market, resulting in a steady decrease in wholesale prices with less generation hours and margin pressure for conventional power plants. The market is thus becoming increasingly diverse, a trend that is further demonstrated by the recent decision from German incumbents RWE and E.ON to split their businesses to focus on conventional energy business on the one hand and the renewable business on the other hand.

In sum, the ease and speed of access with which market participants have access to the underlying commodity is considerably low and hence the position limits contribution to the prevention of market abuse in these markets is perceived to be low too.

<ESMA\_QUESTION\_PLPM\_3>

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

<ESMA\_QUESTION\_PLPM\_4>

We do not believe that the position limits regime has contributed to or improved the orderly pricing and orderly settlement of commodity derivatives markets. This is because ensuring orderly pricing and orderly settlement is one of the key tasks of an exchange and has been achieved already by a broad range of measures to avoid that any factors which might impact the price formation process are prevented. Open positions have little impact on trading activities and play therefore only a minor factor. Of much more importance are technical risks and other manipulative patterns stemming from order handling (such as painting the tape, spoofing, layering, momentum ignition, ping orders pump and dump etc). Should transactions be used for trying to manipulate the market by sending misleading price signals, the individual trade and not a position is relevant. Especially the settlement price, as the strongest market signal, is based on order prices, trade prices or fair values and is entirely independent of members’ positions. Hence, position limits do not have a positive impact on the settlement of a contract. Rather, by excluding market participants from trading, they limit the execution of trades and could have a negative impact on the orderly pricing of contracts, as well as on the general transparency in the market.

For Eurex, and particular, the independent trading surveillance angle, as lined out before – for cash-settled products the position limit regime is not considered useful.

<ESMA\_QUESTION\_PLPM\_4>

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

<ESMA\_QUESTION\_PLPM\_5>

As mentioned above, in our opinion, the MiFID II position limits regime has so far been able to function in a reasonable manner for a number of well-developed and mainly physical benchmark contracts. These highly developed markets are characterised by a large number of different types of active trading firms and an overall substantial amount of open interest. However, for the development of new products and further growth of the existing illiquid commodity derivative markets, the position limits regime has proven to be a substantial barrier.

Fast growing markets in particular have suffered from:

1. The de minimis limit of 2,500 lots which appears to be too restrictive when a contract comes close to 10,000 lots of open interest. For examples in freight and gas, see answer to Q1.
2. The lack of flexibility in the rules for NCAs to deal with special circumstances (by for example using anticipated instead of current or past open interest). For example in freight and power, see answer to Q1.
3. The slow pace with which bespoke position limits are set and reviewed. For examples in freight and power, see answer to Q1.
4. The relatively complex process to apply for a hedging exemption, as well as the fact that the hedging exemption is only available for non-financial entities, even though there also financial entities engaging in genuine hedging activities, see answer to Q1 and Q16.

Furthermore, we believe that the regime may contribute to pushing the liquidity to the largest exchange hosting a benchmark contract, if materially different position applies to similar contracts listed by different exchanges.

Considering the limited contribution that the position limits regime has on orderly pricing and orderly settlement and prevention of market abuse, **we believe the objective of this review should be to have a more proportionate and efficient position limits regime.** **This can be achieved by focusing the application of the MiFID II position limits regime on a selected set of important, critical (benchmark) commodity derivative contracts.** Such a refocus of the position limit regime on (e.g. physical) benchmark contracts would make it more efficient, mitigate the unintended consequences and reduce the compliance burden for all concerned parties (market participants, trading venues, NCAs/ESMA). Most importantly, such a targeted approach would allow new and nascent products to develop, in line with the policy objective of the Directive as expressed in its implementing RTS 21:

*“Position limits should not create barriers to the development of new commodity derivatives and should not prevent less liquid sections of the commodity derivative markets from working adequately“.*

At the same time, we believe that such an amendment would better fulfil the overall objective of MiFID II to “*improve the functioning and transparency of commodity markets and address excessive commodity price volatility*”. A refocus of the systems is justified as the price formation mainly occurs in mature products which serve as benchmarks for the respective market. New and nascent products constitute a minor share of commodity markets. Such contracts are unlikely to influence price movements in the underlying physical commodity markets and thus do not negatively impact consumers. Moreover, in order to prevent market squeezes, it would be sufficient to set limits for the period right before expiry rather than covering the entire maturity curve. Finally, limiting the scope of the position limits regime would bring us closer to regulatory level-playing field between the EU and US commodity markets and protect the liquidity and competitiveness of EU commodity markets.

The other (non-significant) contracts would remain subject to the position reporting regime under MiFID II Art. 58, the pre-existing position monitoring and position management measures by exchanges and the market oversight practices of the exchanges’ market supervision and market surveillance departments that apply the principles laid down in REMIT and MAR. Thus, removing position limits for such contracts would not pose any risk to the transparency and functioning of the respective markets. On the contrary, attracting more volume to regulated venues would contribute to a more transparent trading environment.

However, should such a refocus not be possible, then RTS 21 should suspend the application of the spot and other months’ position limit for commodity derivatives traded on a trading venue with a total combined open interest in spot and other months' contracts not exceeding 20,000 lots over a consecutive three-month period (where this assessment must take place over the total period, and not on a Day 1/single day basis).

Instead of or in addition to limiting the scope of the position limits regime would be to review the position limits regime in view of making it more flexible, not only for NCAs to deal with special circumstances such as index transfers and bidding zone splits, but also for NCAs to deal with a breach of the position limit in general. So far the majority of breaches of EEX Group position limits were related to errors in position reporting, the lack of a hedging exemption or the lack of a liquidity provision exemption. We believe that there is merit for the position limits regime to function as a warning system that alert NCAs whenever there is a breach so that NCAs can start to investigate whether there is an actual risk of market abuse. In the case of gas and power derivatives, it could be the responsibility of the NCA to forward the case to ACER whose main task is to prevent market abuse.

<ESMA\_QUESTION\_PLPM\_5>

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

<ESMA\_QUESTION\_PLPM\_6>

The position management controls have led to a loss of liquidity especially in new and illiquid contracts as they prevent major market participants to support an exchange on its way to reach the minimum liquidity which is necessary to attract trading companies to trade these new contracts. For examples in freight and gas, please see our response to Q1.

<ESMA\_QUESTION\_PLPM\_6>

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

<ESMA\_QUESTION\_PLPM\_7>

We do not believe that the position limits regime in its current form, including the position management controls laid down in MiFID II Art. 57, has contributed to the prevention of market abuse. For details see our answer to questions 1 and 3.

This is because our market oversight activities, including the compliance, supervision and surveillance activities, as well as the pre-existing regulations were already effective in preventing market abuse and excessive speculation and are better tailored to monitor the full range of manipulative patterns and hence to prevent market manipulation.

<ESMA\_QUESTION\_PLPM\_7>

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

<ESMA\_QUESTION\_PLPM\_8>

As stated in our response to Q4, we do not believe that the position limits regime in its current form, including the position management controls laid down in MiFID II Art. 57, has contributed to or improved the orderly pricing and settlement. Pricing and settlement are based on order and trading activities and not on position holdings.

DBG exchanges have installed position management control mechanisms to ensure orderly settlement (please also refer to our responses to questions 3 and 9):

Position management controls adopted by Eurex on broad-based commodities index derivatives have no direct impact on orderly pricing and settlement conditions. At the moment, most commodity derivatives contracts are quoted over the trading with size far below (usually 10 contracts on each side) the position limit size of 2,500 contracts. Prices are generated through order matching within the price range established by the quotation. So, the price limit of orders and quotes primarily impacts the price.

Potentially, position limits could impact pricing, if several market participants would buy or sell contracts in a quantity that would lead to position limit breach on the side of the market maker, who would be consequently obliged to take out his quotes. As a consequence, orderly and fair pricing could be impeded since no pricing indication is given by the liquidity provider / market maker, as mentioned before in the response to Q1 of this questionnaire.

Furthermore, a missing quotation impacts the liquidity of the market what makes the opening and closing of a position more difficult. The daily settlement price is determined based on the average bid / ask spread of the combination order book before the reference point (17:30 CET) in time. As described above, the price level of the quotation is only potentially impacted by position limits. Consequently, also the daily settlement price, which is based on the quotation, is only potentially impacted by position limits due to the reasons given above.

The final settlement price is established by Eurex on the last trading day. The final settlement price is based on the closing price of the respective index on that day, provided no futures represented in the index is suspended at that time. The final settlement price is fixed with three decimal places. Consequently, the final settlement price is not impacted by the position limits.

Although little impact overall can be seen on Eurex in regard to orderly price formation, it is recommended to take the holistic picture and the unintended consequences as depicted in the responses to previous questions, especially Q1.

<ESMA\_QUESTION\_PLPM\_8>

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

<ESMA\_QUESTION\_PLPM\_9>

As suggested in the response to the previous questions, DBG exchanges have installed surveillance and supervision systems as well as position management controls.

Eurex, EEX and Powernext market surveillance departments are monitoring positions continuously every exchange trading day. Moreover, they have put in place automatic controls to detect when a member’s position approaches the limit. In this case, the department contacts the member to inform them about a potential breach and verifies if the member has successfully applied for a hedging exemption.

In case a member has breached the limit, our market surveillance departments inform their respective NCA which then takes action, if needed.

<ESMA\_QUESTION\_PLPM\_9>

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

<ESMA\_QUESTION\_PLPM\_10>

As mentioned in our response to questions 1 and 5, in our opinion, the MiFID II position limits regime has so far been able to function in a reasonable manner for a number of well-developed benchmark contracts. These highly developed markets are characterised by a large number of different types of active trading firms and an overall substantial amount of open interest. However, for the development of new products and further growth of the existing illiquid commodity derivative markets, the position limits regime has proven to be a substantial barrier.

Fast growing markets in particular have suffered from:

1. The de minimis limit of 2,500 lots which appears to be too restrictive when a contract comes close to 10,000 lots of open interest. For examples in freight and gas, see answer to Q1.
2. The lack of flexibility in the rules for NCAs to deal with special circumstances (by for example using anticipated instead of current or past open interest). For example in freight and power, see answer to Q1.
3. The slow pace with which bespoke position limits are set and reviewed. For examples in freight and power, see answer to Q1.
4. The relatively complex process to apply for a hedging exemption, as well as the fact that the hedging exemption is only available for non-financial entities, even though there also financial entities engaging in genuine hedging activities, see answer to Q1 and Q16.

Furthermore, we believe that the regime may contribute to pushing the liquidity to the largest exchange hosting a benchmark contract, if materially different position applies to similar contracts listed by different exchanges.

Considering the limited contribution that the position limits regime has on orderly pricing and orderly settlement and prevention of market abuse, we believe the objective of this review should be to have a more proportionate and efficient position limits regime. This can be achieved by focusing the application of the MiFID II position limits regime on a selected set of important, critical (benchmark) commodity derivative contracts. Such a refocus of the position limit regime on benchmark contracts would make it more efficient, mitigate the unintended consequences and reduce the compliance burden for all concerned parties (market participants, trading venues, NCAs/ESMA). Most importantly, such a targeted approach would allow new and nascent products to develop, in line with the policy objective of the Directive as expressed in its implementing RTS 21 which stipulates that:

*“Position limits should not create barriers to the development of new commodity derivatives and should not prevent less liquid sections of the commodity derivative markets from working adequately“.*

At the same time, we believe that such an amendment would better fulfil the overall objective of MiFID II to “*improve the functioning and transparency of commodity markets and address excessive commodity price volatility*”.

A refocus of the systems is justified as the price formation mainly occurs in mature products which serves as benchmarks to the respective market. New and nascent products constitute a minor share of commodity markets. Such contracts are unlikely to influence price movements in the underlying physical commodity markets and thus do not negatively impact consumers. Moreover, in order to prevent market squeezes, it would be sufficient to set limits for the period right before expiry rather than covering the entire maturity curve. Finally, limiting the scope of the position limits regime would bring us closer to regulatory level-playing field between the EU and US commodity markets and protect the liquidity and competitiveness of EU commodity markets.

The other (non-significant) contracts would remain subject to the position reporting regime under MiFID II Art. 58, the pre-existing position monitoring and position management measures by exchanges and the market oversight practices of the exchanges’ market supervision and market surveillance departments that apply the principles laid down in REMIT and MAR. Thus, removing position limits for such contracts would not pose any risk to the transparency and functioning of the respective markets. On the contrary, attracting more volume to regulated venues would contribute to a more transparent trading environment.

However, should such a refocus not be possible, then RTS 21 should suspend the application of the spot and other months’ position limit for commodity derivatives traded on a trading venue with a total combined open interest in spot and other months' contracts not exceeding 20,000 lots over a consecutive three-month period (where this assessment must take place over the total period, and not on a Day 1/single day basis).

Instead of or in addition to limiting the scope of the position limits regime another approach would be to review the position limits regime in view of making it more flexible, not only for NCAs to deal with special circumstances such as index transfers and bidding zone splits, but also for NCAs to deal with a breach of the position limit in general. So far the majority of breaches of EEX Group position limits were related to errors in position reporting, the lack of a hedging exemption or the lack of a liquidity provision exemption. We believe that there is merit for the position limits regime to function as a warning system that alert NCAs whenever there is a breach so that NCAs can start to investigate whether there is an actual risk of market abuse. In the case of gas and power derivatives, it could be the responsibility of the NCA to forward the case to ACER whose main task is to prevent market abuse.

<ESMA\_QUESTION\_PLPM\_10>

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

<ESMA\_QUESTION\_PLPM\_11>

The future relationship between the UK and EU, in particular the legal framework for cross-border services, is yet to be agreed. Lacking a ratified withdrawal agreement between the UK and EU, all EU law will cease to apply to the UK from 1 November 2019 and the UK will then become a “third country”. Like any market participant, DBG has been preparing for any scenario that may unfold in light of Brexit, to ensure that our customers continue to have the ability to trade and clear with us.

Post-Brexit, close cooperation between the EU and UK regarding the implementation and enforcement of rules will be important to ensure a level playing field and stability in global commodity derivatives markets. In general, a guiding principle in this context should be the assurance of reciprocal market access under equivalent conditions. We believe that a comprehensive approach at EU level to equivalence decisions and their long-term applicability should be taken in order to ensure that the conditions under an equivalence regime granted are effectively maintained.

We understand that post-Brexit, in case any equivalence decision is considered, the UK is required to maintain an equivalent regulatory framework that includes a position limits regime, a pre-trade transparency regime and similar reporting obligations. Though we are concerned that it might be implemented in a more efficient way by for example removing the obstacles for the development of new, illiquid and less liquid contracts.

It is noteworthy that for commodity derivative topics Level 3 legislation has had a significant impact on the final implementation of the regime. In other words, the technical details are often essential to determine whether the overall regime is equivalent or not. Furthermore, in case any equivalence decision is considered, we fear that commodity derivative topics will not be the most important element of ESMA’s equivalence assessment.

However, rather than calling for a full level playing field between EU27 commodity exchanges and UK venues, we believe the focus of EU institutions should be on making the EU regulatory framework fit for purpose and the commodities trading industry highly competitive compared to other jurisdictions.

<ESMA\_QUESTION\_PLPM\_11>

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

<ESMA\_QUESTION\_PLPM\_12>

See our response to questions 3 and 4. Depending on the asset class the position limits have had a limited to no contribution to the prevention of market abuse and orderly pricing and orderly settlement.

Please see our response to Q13, outlining which commodity derivative contracts could potentially benefit from a position limits regime.

For the reasons expressed in responses to previous questions, we would like to highlight our concern in the lack of development of derivatives trading on transparent exchange markets, and the impact on market participants in commodity asset classes that are wrongly captured under the definition, namely cash-settled derivatives on broad-based commodities index underlying.

Especially for these contracts, it does not seem reasonable to have an additional limit on the index derivative, as the individual components are already under a position limit regime on the exchanges where these are traded. To our view, it makes no sense, as a) position limits are already set on an individual level with more thoughts and knowledge on market characteristic and market structural aspects locally and b) the commodity index products are cash-settled, and it is not possible to squeeze (corner) a market like in physical delivered derivatives contracts. In addition, it is already defined in the index methodology, that for each individual commodity future, the front-month contract is rolled into the back-month well before expiry. This further describes a corrective market measure.

<ESMA\_QUESTION\_PLPM\_12>

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

<ESMA\_QUESTION\_PLPM\_13>

Yes, considering the limited contribution that the position limits regime has on orderly pricing and orderly settlement and the prevention of market abuse (see our response to questions 3 and 4) as well as the obstacles it has created for the development of new, illiquid and less liquid contracts (see our response to Q1), **we believe there are merits in focusing the application of the MiFID II position limits regime on a selected set of important, critical (benchmark) commodity derivative contracts**.

Such a refocus of the position limit regime on benchmark contracts would make it more efficient, mitigate the unintended consequences and reduce the compliance burden for all concerned parties (market participants, trading venues, NCAs/ESMA). Most importantly, such a targeted approach would allow new and nascent products to develop, in line with the policy objective of the Directive as expressed in its implementing RTS 21 which stipulates that:

*“Position limits should not create barriers to the development of new commodity derivatives and should not prevent less liquid sections of the commodity derivative markets from working adequately“.*

At the same time, we believe that such an amendment would better fulfil the overall objective of MiFID II to *“improve the functioning and transparency of commodity markets and address excessive commodity price volatility”*. A refocus of the systems is justified as the price formation mainly occurs in mature products which serve as benchmarks for the respective market. New and nascent products constitute a minor share of commodity markets. Such contracts are unlikely to influence price movements in the underlying physical commodity markets and thus do not negatively impact consumers. Moreover, in order to prevent market squeezes, it would be sufficient to set limits for the period right before expiry rather than covering the entire maturity curve. Finally, limiting the scope of the position limits regime would bring us closer to regulatory level-playing field between the EU and US commodity markets and protect the liquidity and competitiveness of EU commodity markets.

When reviewing the scope of the position limits we believe that the following criteria, among others, should be taken into account:

* The contract has to be physically delivered.
* It has to be easy for market participants to restrict or control the underlying market.
* The contract is important for price formation in the underlying market.

The other (non-significant) contracts would remain subject to the position reporting regime under MiFID II Art. 58, the pre-existing position monitoring and position management measures by exchanges and the market oversight practices of the exchanges’ market supervision and market surveillance departments that apply the principles laid down in REMIT and MAR. Thus, removing position limits for such contracts would not pose any risk to the transparency and functioning of the respective markets. On the contrary, attracting more volume to regulated venues would contribute to a more transparent trading environment.

However, **should such a refocus not be possible, then RTS 21 should suspend the application of the spot and other months’ position limit for commodity derivatives traded on a trading venue with a total combined open interest in spot and other months' contracts not exceeding 20,000 lots over a consecutive three-month period** (where this assessment must take place over the total period, and not on a Day 1/single day basis).

Furthermore, for the reasons mentioned above in responses to previous questions **for cash-settled commodities derivatives contracts based on broad-based indices the regime does not to add value and quite contrary seems to distort the roles of market participants and their trading needs, and as a result limits the full potential of derivatives trading and shift of OTC trading to transparent exchange markets.** It is therefore considered counterproductive for cash-settled derivatives contracts on broad-based indices as traded on Eurex, and impairs market transparency development and growth, as well as a failing to contribute to harmonised regime that reflects global trading needs and regimes.

We strongly recommend refocusing the application of the regime to fit the legislative objective, the unintended consequence identified, especially in cash-settled commodities derivatives contracts on broad-based index underlyings, the lack of global rule harmonization and trading needs and standards.

<ESMA\_QUESTION\_PLPM\_13>

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

<ESMA\_QUESTION\_PLPM\_14>

We believe that the regime provides a workable solution for securitised commodity derivatives – in particular based on the provisions for illiquid securities in Art. 15 of Delegated Regulation (EU) 2017/591 – and therefore we do not ask for any specific amendments in this regard. In the case, that the provisions for illiquid securities will be amended with regard to other kind of derivatives than securitised derivatives, there is the need for an in-depth assessment of consequences.

<ESMA\_QUESTION\_PLPM\_14>

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

<ESMA\_QUESTION\_PLPM\_15>

Rather than extending the scope of the position limits regime (by broadening the definition of EEOTC and same contracts) and ensuring a level playing field between exchange and OTC trading, as well as between exchanges, we believe that the focus of the review should be on making the position limits regime more proportionate and efficient. Please refer to our answers to questions 1, 5 and 13.

<ESMA\_QUESTION\_PLPM\_15>

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

<ESMA\_QUESTION\_PLPM\_16>

*The hedging exemption:*

In line with Europex and FESE, we believe that the hedging exemption should also become available for financial entities. Investment banks as well as commodity trading houses play a vital role in providing smaller commercial players with access to commodity derivatives markets. Moreover, also commercial players can be an investment firm under MiFID II. This does not imply that they do not need a hedging exemption anymore for the commercial activities they are undertaking as their main business.

In iron ore and freight, for example, it is possible and sometimes common that a bank would finance a miner or steel mill with the caveat that the business needs to initiate a hedging programme to remove volatility from future costs or revenues (or both). The hedging programme would usually be conducted with the bank on an OTC basis with the bank then offsetting that risk in the cleared market.

Even though within the context of such transaction the bank clearly performs a hedging activity, it would not be able to make use of the exemption envisaged under MiFIR Art. 8 or MiFID Art. 57.

*The liquidity provision exemption:*

Another obstacle to the development of new contracts, such as EEX agriculture and EEX dry bulk freight contracts, has been a lack of a liquidity provision exemption in combination with the de minimis limit being too restrictive.

Contrary to the general ancillary activity exemption regime, the position limits regime does not include a liquidity provision exemption. An exemption, as outlined in Art. 2(4) of MiFID II, is particularly necessary for new contracts that need financial entities to incentivise trading in the contract, at least if the position limits regime continues to include the restrictive 2,500 lots limit on new and illiquid contracts. If no such exemption is available and the 2,500 lots limit continues to apply, exchanges have to contract a “panel” of liquidity providers to ensure that none of these firms exceed the 2,500 lots limit. In nascent markets it is highly possible that there may not be the required number of counterparties to build such a “panel” and even where this is the case, it adds significant costs for the exchange.

In order to avoid such a situation, we recommend that the position limits regime includes such an exemption based on the same conditions as the liquidity provision exemption outlined in Art. 2(4) of MiFID II and the ESMA Q&A on MiFID II / MiFIR commodity derivative topics, and implemented similarly to the hedging exemption under the position limits regime.

<ESMA\_QUESTION\_PLPM\_16>

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

<ESMA\_QUESTION\_PLPM\_17>

Yes, please see our answer to questions 1, 5 and 10 on the need for more flexibility for NCAs in setting position limits.

First of all, it has to be noted that for power and gas the significant difference between deliverable supply and open interest can be explained by the fact that trading is still happening predominantly bilaterally and is taking place on different exchanges. It is therefore normal that the open interest of exchange-traded derivatives is relatively low compared to the underlying market. To effectively prevent market abuse, it is necessary to adjust the position limit upwards, if deliverable supply is significantly higher than the open interest. This is facilitated by Art. 18 par. 3 of the Delegated Regulation (EU) 2017/591 but not always consistently applied by NCAs.

Secondly, we believe that optionality to use open interest for both spot and other month contracts could prevent unintended consequences of the position limits regime for certain commodity derivative contracts which serve as pricing benchmarks and risk-management proxies in the absence of direct hedging instruments. However, setting limits for both spot and other months based on open interest should be an optionality and by no means a rule in setting position limits. It should be conditioned upon specific characteristics and functions of a commodity derivative contract in question.

<ESMA\_QUESTION\_PLPM\_17>

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

<ESMA\_QUESTION\_PLPM\_18>

Yes, considering in particular the significant impact that the MiFID II position limit regime has had on the development of new, illiquid and less liquid contracts, we believe changes to make the regime more proportionate and efficient are urgently required. For details, please see our response to Q10 and Q13.

<ESMA\_QUESTION\_PLPM\_18>

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

<ESMA\_QUESTION\_PLPM\_19>

Yes. We support the introduction of a forward-looking model whereby the position limit is calculated based on a form of extrapolation of the market’s historical development of open interest in the case of other month contracts and deliverable supply in the case of spot month contracts. This approach would be better suited to accommodate for periods of strong market growth.

Under the existing model a position limit is based on a percentage of the average amount of open interest in a contract of a certain historical period, which is usually a one, three, six or twelve months period depending on the characteristics of the commodity market. This backward-looking methodology inherently does not properly capture the potential future growth of a market and risks applying an over-restrictive limit when a market experiences a period of strong growth. At a minimum and where appropriate, it should therefore be allowed to use the smallest possible period for the calculation of open interest levels (i.e. the average open interest of the most recent trading day) under the existing rules.

Furthermore, the introduction of a forward-looking model would be one way of dealing with the special circumstances we highlighted in our response to Q1. E.g. if NCAs would be allowed to base the position limit on anticipated growth, it would have been able to deal with the index transfers in EEX freight products as well as the German/Austrian power bidding zone split.

Importantly, this forward-looking approach should not only apply to setting the limits, but also to classifying contracts as liquid or not. This way, it could prevent that the development of markets are hampered by a delay in the application of a bespoke limit by a NCA, at least if the position limits regime continues to include a restrictive 2,500 lots limit for illiquid contracts. Alternatively, the 2,500 lots limit should automatically cease to apply, as soon as the contract has become liquid.

<ESMA\_QUESTION\_PLPM\_19>

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

<ESMA\_QUESTION\_PLPM\_20>

If ESMA believes there is a need to provide its views on the methodologies used by exchanges to calculate open interest for the purpose of position limits by means of level 3 guidance, then we consider the use of gross open interest as the most appropriate of the different methodologies that NCA’s should be able to allow exchanges to implement. This is because the usage of net open interest to determine the other month position limit would be inappropriate as it does not properly reflect trading on behalf of clients. For example, if a member holds 5 lots long for client A and 5 lots short for client B, this position should not be netted, as the positions belong to different beneficial owners. To recall, position limits apply to the person holding the position, meaning the end beneficiary is concerned.

Let us assume as another example that A is a member of the exchange serving client CA and B is a member of the exchange that serves a client called CB. Then A might buy on behalf of CA 100 units of a certain commodity and sell on its own account the same quantity. If B does the same with his client, then this leads to the following position in the sense of MiFID II position limits.

A: 100 units short

CA: 100 units long

B: 100 units short

CB: 100 units long

The gross open interest is the sum of all long or short positions, i.e. 200 units. The relative positions of each party are 50% each (separately for long and short positions). On the contrary, the net open interest would be zero, since the position that A and B are holding on their accounts would be netted against the positions that they hold on behalf. For this reason, it is more appropriate to use gross open interest. Using net open interest – if it can be calculated at all - would mean that the size of the end beneficiary’s position will be compared with a figure that will be considerably smaller than the sum of all end beneficiary’s positions.

For this reason we believe that gross open interest is the most appropriate open interest calculation methodology for the purpose of position limits.

<ESMA\_QUESTION\_PLPM\_20>

1. : How useful do you consider the information on position management controls available on ESMA’s website?

<ESMA\_QUESTION\_PLPM\_21>

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<ESMA\_QUESTION\_PLPM\_21>

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

<ESMA\_QUESTION\_PLPM\_22>

Given the plethora of position management controls and mapping those to the part that an exchange can actually monitor, namely only the trading on the exchange, we deem the amount and scope of controls as appropriate and do not consider any further requirements on position management controls to be necessary.

As stated in our response to questions 3 and 9, our market oversight activities, including the compliance, supervision and surveillance activities, as well as the pre-existing regulations have been effective in preventing market abuse and ensuring orderly trading and settlement in our commodity markets.

<ESMA\_QUESTION\_PLPM\_22>