EUROPEAN
COMMISSION

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COMMISSION DELEGATED REGULATION (EU) …/...

of 1.12.2016

supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the application of position limits to commodity derivatives

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

The Markets in Financial Instruments Directive (Directive 2014/65/EU, MiFID II) requires Member States to ensure that competent authorities, in line with ESMA's methodology, establish and apply position limits on the size of a net position which a person can hold at all times in commodity derivatives traded on trading venues and economically equivalent OTC ('EEOTC') contracts. The aim of the introduction of position limits on commodity derivatives is to improve the stability and integrity of European financial markets.

In this context, Article 57(3) and (12) of MiFID II empower ESMA to develop Regulatory Technical Standards (RTS) providing the basis of the methodology for the calculation and application of position limits in order to establish a harmonised position limits regime across commodity derivatives traded on trading venues and EEOTC contracts. Article 57(3) requires ESMA to specify how competent authorities should take into account seven factors when establishing the spot month position limits and other months' position limits for physically settled and cash settled commodity derivatives. Article 57(12) requires ESMA to determine how the position limits methodology should be applied, for example, in the aggregation of positions within a group, when a position may be qualified as reducing risk or when a firm may use a hedging exemption.

The draft regulatory technical standard was first submitted to the Commission on 28 September 2015. In April 2016, the Commission notified ESMA of its intention to endorse this draft standard subject to a number of changes in accordance with Article 10(1) of Regulation No (EU) 1095/2010 establishing the ESMA. On 2 May 2016, ESMA submitted this revised draft technical standard to the Commission.

This draft RTS contains further provisions which create a more stringent regime for liquid contracts whose underlying is food for human consumption. Compared to the ESMA proposal, it also caps the upper position limits for new and illiquid contracts to 40%. It also specifies that upper position limits of up to 50% can be imposed on a temporary basis. Finally, the proposed methodology specifies how competent authorities are to consider volatility when setting position limits.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In accordance with Article 10 of the Regulation (EU) 1095/2010 ESMA has carried out a public consultation on the draft regulatory technical standards. A consultation paper was published on 19 December 2014 on the ESMA website and the consultation closed on 2 March 2015. In addition, the ESMA sought the views of the Securities and Markets Stakeholder Group (SMSG) established in accordance with Article 37 of the ESMA Regulation. The SMSG chose not to provide advice on these issues due to the technical nature of the standards.

Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation (EU) No 1095/2010, the ESMA has submitted its impact assessment, including the analysis of costs and benefits related to the draft technical standards. This analysis is available at http://www.esma.europa.eu/system/files/2015-esma-1464_annex_ii_-_cba_-_draft_rts_and_its_on_mifid_ii_and_mifir.pdf.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

This Delegated regulation sets out the standard methodology which should be used by National Competent Authorities in order to calculate and apply position limits in a harmonised way across commodity derivatives traded on traded venues and economically equivalent OTC contracts. The delegated regulation provides for a baseline limit and ways to adjust this limit based on seven factors for spot and other months' physically settled and cash settled contracts.

The delegated regulation also contains provisions to specify the application of the methodology: how and when positions should be aggregated, when contracts should be considered the same; and when OTC contracts should be considered economically equivalent. Finally, the regulation lays down rules to specify when a commodity derivative position can be qualified as risk reducing.

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments[1], and in particular Article 57(3) and (12) thereof,

Whereas:

(1) In order to ensure a harmonised approach to applying position limits to commodity derivatives in the Union, a methodology should be specified for calculating those limits. The methodology should prevent regulatory arbitrage and promote consistency whilst providing competent authorities with sufficient flexibility to take into account the variations among different commodity derivatives markets and the markets in the underlying commodities. The methodology for calculating the limits should allow competent authorities to balance the objectives of setting limits at a level sufficiently low to prevent persons holding positions in those commodity derivatives from abusing or distorting the market against the objectives of supporting orderly pricing and settlement arrangements, developing new commodity derivatives and enabling commodity derivatives to continue to support the functioning of commercial activities in the underlying commodity market.

(2) In order to clearly identify a limited number of concepts stemming from Directive 2014/65/EU, as well as to specify technical terms necessary for this Regulation, a number of terms should be defined to ensure uniform application.

(3) Long and short positions in a commodity derivative of market participants should be netted off against each other to determine the effective size of a position a person controls at any point in time. The size of a position held through an option contract should be calculated on a delta equivalent basis. As this Regulation applies a different methodology to the calculation of position limits for spot and other months' contracts, such netting should be applied separately to the spot and other months' positions.

(4) Directive 2014/65/EU requires that any positions held by other persons on behalf of a person should be included in the calculation of that person's position limit and for position limits to be applied at both an entity level and at a group level and it is therefore necessary to aggregate positions at a group level. It is appropriate to only provide for aggregation at the group level if a parent undertaking can control the use of

[1] OJ L 173, 12.6.2014, p. 173

positions. Accordingly, parent undertakings should aggregate positions held by their subsidiaries with any positions that the parent entity holds directly, in addition to the subsidiaries aggregating their own positions. Such aggregation can lead to positions calculated at the level of the parent undertaking which are larger or, due to a netting of long and short positions held by different subsidiaries, lower than at individual subsidiary level. Positions should not be aggregated at the level of the parent undertaking if the positions are held by collective investment undertakings which hold those positions on behalf of their investors rather than on behalf of their parent undertakings in cases where the parent undertaking cannot control the use of those positions for its own benefit.

(5) The concept of the same commodity derivative should establish a demanding threshold to prevent persons from inappropriately netting positions across dissimilar commodity derivatives in order to circumvent and weaken the robustness of the position limit on the principal commodity derivative contract. This should not prevent competent authorities from setting similar position limits for similar commodity derivative contracts under the coordination of the European Securities and Markets Authority (ESMA). Commodity derivatives should only be considered as trading in significant volume on a trading venue if they exceed the liquidity threshold specified in this Regulation for a sufficient period of time.

(6) Where an over-the-counter (OTC) contract is valued on the same underlying commodity that is deliverable at the same location and with the same contractual conditions and if it is having a highly correlated economic outcome to a contract traded on a trading venue, it should be deemed economically equivalent regardless of small differences in the contractual specifications concerning the lot sizes and the date of delivery. Also differences in post trade risk management arrangements, such as clearing arrangements, should not be barriers to declaring such contracts as economically equivalent. In order to prevent inappropriate netting of potentially dominant positions traded on a trading venue by the use of bilateral arrangements in OTC contracts and to ensure an efficient operation of the position limits regime in practice it is necessary for commodity derivatives traded OTC to be considered economically equivalent to trading venue contracts only in limited circumstances. To deter avoidance of position limits and to enhance the integrity of the position limit regime it is necessary that a definition of an economically equivalent OTC contract is narrowly framed so that it does not permit a person to net an OTC position against multiple other positions or to exercise discretion in the choice of positions against which it is netted.

(7) In order to establish which positions in commodity derivatives are objectively measurable as reducing risks directly relating to commercial activity, certain criteria should be provided, including the use of the accounting definition of a hedging contract based on International Financial Reporting Standards (IFRS) rules. That accounting definition should be also available to non-financial entities even though they do not apply IFRS rules at an entity level.

(8) Additionally, non-financial entities should be able to use risk management techniques to mitigate their overall risks arising from their commercial activity or that of their group, including risks arising from several geographic markets, several products, time horizons or entities ('macro or portfolio hedging'). When a non-financial entity uses macro or portfolio hedging, it may not be able to establish a one-to-one link between a specific position in a commodity derivative and a specific risk arising from the commercial activity that the commodity derivative is intended to hedge. A non-

financial entity may also use a non-equivalent commodity derivative to hedge a specific risk arising from commercial activity where an identical commodity derivative is not available or where a more closely correlated commodity derivative does not have sufficient liquidity (‘proxy hedging’). In such cases, risk management policies and systems should be able to prevent non-hedging transactions from being categorised as hedging and should be able to provide for a sufficiently disaggregate view of the hedging portfolio so that speculative components are identified and counted towards the position limits. Positions should not qualify as reducing risks related to commercial activity solely on the grounds that they have been included as part of a risk-reducing portfolio on an overall basis.

(9) A risk may evolve over time and, in order to adapt to the evolution of the risk, commodity derivatives initially executed for reducing risk related to commercial activity, may have to be offset through the use of additional commodity derivative contracts that close out those commodity derivative contracts that have become unrelated to the commercial risk. Additionally, the evolution of a risk that has been addressed by the entering into of a position in a commodity derivative for the purpose of reducing risk should not subsequently give rise to the re-evaluation of that position as not being a privileged transaction ab initio.

(10) Non-financial entities should be able to apply for the exemption in relation to hedging of commercial activities before entering into a position. The application should give the competent authority a clear and concise overview of the commercial activities of the non-financial entity in respect of an underlying commodity, the associated risks and how commodity derivatives are utilised to mitigate those risks. Position limits apply at all times and should the exemption ultimately not be granted by the competent authority, the non-financial entity should reduce any position in excess of a limit accordingly and may face supervisory measures in respect of a breach of a limit. Non-financial entities should re-assess their activities periodically to ensure that the continued application of the exemption is justified.

(11) The spot-month period, which is the time period immediately before delivery at expiry, is specific to each commodity derivative and may not correspond to exactly one month. Spot month contracts should therefore refer to the contract that is the next contract in that commodity derivative to mature. Restricting the positions a person may hold in the period during which delivery of the physical commodity is to be made limits the quantity of the underlying deliverable supply each person may make or take delivery of, thereby preventing the accumulation of dominant positions by individuals which may enable them to squeeze the market through restricting access to the commodity. The standard baseline for the spot month position limit for both physically and cash settled commodity derivatives should therefore be computed as a percentage of the deliverable supply estimate. Competent authorities should be able to implement a schedule of decreasing position limits ranging from the point in time when a contract becomes a spot month contract until maturity in order to more precisely ensure that position limits are adequately set throughout the spot month period and to ensure orderly settlement.

(12) The other months’ position limit is applied across all maturities other than the spot month. The standard baseline for the other months’ position limits for both physically and cash settled commodity derivatives should be computed as a percentage of the total open interest. The distribution of positions across the other months’ of a commodity contract is often concentrated in the months closest to maturity. Therefore

total open interest provides a more appropriate baseline for setting position limits than using a figure averaged across all maturities.

(13) The standard baseline of 25% of deliverable supply and of open interest has been set with reference to the experience of other markets and other jurisdictions. The baseline should be adjusted by competent authorities to enable it to be reduced by a maximum of 20% (or 22.5% in the case of some agricultural commodity derivatives) and to be increased by a maximum of 10% (or 15% in the case of less liquid commodity derivatives) should the characteristics of the market require it, such as an absence of market participants, in order to support the orderly settlement and functioning of the contract and its underlying market. Since any adjustment to the baseline figure applies only where, and for so long as, objective characteristics of the market require it, temporary adjustments to the baseline should be therefore possible. Competent authorities should ensure that an adjustment downwards of the baseline is effected whenever it is necessary to prevent dominant positions and to support orderly pricing in the commodity derivative and in the underlying commodity. The range reflects that Directive 2014/65/EU covers a wider range of commodity derivatives and markets than other markets and jurisdictions. The definition of commodity derivative under Article 2(1)(30) of Regulation 600/2014 of the European Parliament and the Council[2] is broad, comprising also securitised derivatives and cash settled derivatives which do not have a tangible underlying such as climatic variables. For securitised derivatives the concept of spot and other months' does not apply. For derivatives without a tangible underlying the deliverable supply cannot be used to establish a position limit. Therefore competent authorities should be able to enhance or adjust the methodologies to determine position limits for these commodity derivatives based on different parameters like number of securities issued or the use of open interest also for the spot month.

(14) Certain commodity derivatives, in particular for power and gas, provide that the underlying be delivered constantly over a specified period of time such as day, month or year. Moreover, certain contracts with longer delivery periods such as year or quarter may be automatically substituted by related contracts of shorter delivery periods such as quarter or month (cascading contracts). In these cases, a spot month position limit for the contract to be substituted prior to delivery would be inappropriate, as such limit would not cover the expiry and physical delivery or cash settlement of the contract. To the extent that delivery periods of contracts for the same underlying overlap, a single position limit should apply to all the related contracts in order to properly take into account the positions across those contracts which may potentially be delivered. To facilitate this, related contracts should be measured in units of the underlying and aggregated and netted accordingly.

(15) For certain agricultural commodity derivatives, which have a material impact on consumer food prices, the methodology enables a competent authority to set a baseline and position limit beneath the minimum of the general range where it finds evidence of speculative activity impacting significantly on prices.

(16) The competent authority should assess whether the factors listed under paragraph 3 of Article 57 of Directive 2014/65/EU necessitate adjustment of the baseline in order to

[2] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 84).

set the final level of the position limit. The assessment should take into account these factors as relevant for the particular commodity derivative in question. The methodologies should provide a direction of how to set the limit without taking away the ultimate decision on an appropriate position limit for a commodity derivative from the competent authority in order to prevent market abuse. The factors should give important indications to the competent authorities and also to ESMA to facilitate forming its opinions and ensuring an adequate alignment of position limits across the Union, including by assessing the impact of volatility on a case by case basis and as frequently as necessary to ensure position limits remain appropriate.

(17) 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. Competent authorities should take into account in applying the methodology the time required to develop and attract liquidity to both new and existing commodity derivatives and, in particular, for commodity derivatives that may support risk management in bespoke or immature markets or seek to develop new hedging arrangements in new commodities. Given the broad range of markets and commodities to which the position limits regime applies, there is no single and predetermined time period which adequately captures the shift from a commodity derivative contract being new to being established. Equally, there are many commodity derivative contracts which may never attract sufficient participants or liquidity to enable the effective application of position limits without the risk of participants regularly and inadvertently breaching the limit and consequently disrupting the pricing and settlement of those commodity derivatives. In order to address these risks to the efficient functioning of markets, the methodology provides for a tiered approach whereby the position limit for the spot month and for other months is set at a fixed level of 2,500 lots for commodity derivatives and 2.5 million securities in issue for securitised derivatives with a commodity underlying until a threshold of 10,000 lots or 10 million securities, respectively, is exceeded. Contracts exceeding these thresholds while still being relatively illiquid should, where appropriate, be able to benefit from a higher limit in order to ensure that trading in such contracts is not unduly constrained.

(18) The number, composition, and the role of market participants in a commodity derivative can influence the nature and the size of positions that certain market participants hold in the market. For some commodity derivatives, certain market participants might hold a large position which reflects their role in the buying and selling of, and the delivery of, the commodity when they are on the opposite side of the market to the majority of other market participants providing liquidity or risk management services for the underlying commodity market.

(19) The supply, use, access to, and availability of the underlying commodity are characteristics of the underlying commodity market. Through the assessment of more granular components of these characteristics, such as perishability of the commodity and method of transportation, the competent authority can determine the flexibility of the market and adjust position limits appropriately.

(20) For some commodity derivatives there may be a large discrepancy between open interest and deliverable supply. This may occur where there is relatively little derivative trading compared with the deliverable supply, in which case open interest will be smaller in comparison with deliverable supply, or, for example, where a particular commodity derivative is widely used to hedge many different risk exposures and deliverable supply is therefore smaller in comparison with open interest. Such

significant discrepancies between open interest and deliverable supply justify adjustments from the baseline applicable to the other months' limit upwards or downwards in order to avoid a disorderly market when the spot month approaches.

(21) With the same objective of limiting disorderly markets as the spot month approaches because of large discrepancies between calculations of deliverable supply and open interest, deliverable supply is defined to include any substitute grades or types of a commodity that can be delivered in settlement of a commodity derivative contract under the terms of that contract.

(22) The new legislation of the European Parliament and of the Council on markets in financial instruments set out in Directive 2014/65/EU and Regulation (EU) No 600/2014 applies from 3 January 2017. To ensure consistency and legal certainty, this Regulation should apply from the same date.

(23) This Regulation is based on the draft regulatory technical standards submitted by ESMA to the Commission.

(24) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council[3],

HAS ADOPTED THIS REGULATION:

CHAPTER I
GENERAL PROVISIONS

Article 1
Subject matter

This Regulation lays down rules for the calculation of the net position held by a person in a commodity derivative and the methodology for calculating the position limits on the size of that position.

Article 2
Definitions

For the purposes of this Regulation, the following definitions shall apply:

(1) 'non-financial entity' means a natural or legal person other than:

(a) an investment firm authorised in accordance with Directive 2014/65/EC,

(b) a credit institution authorised in accordance with Directive 2013/36/EU of the European Parliament and of the Council[4],

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[3] Regulation (EU) No 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).

[4] Directive 2013/36/EUof the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

(c) an insurance undertaking authorised in accordance with Directive 73/239/EEC[5],

(d) an assurance undertaking authorised in accordance with Directive 2002/83/EC of the European Parliament and of the Council[6],

(e) a reinsurance undertaking authorised in accordance with Directive 2005/68/EC of the European Parliament and of the Council[7],

(f) a UCITS and, where relevant, its management company, authorised in accordance with Directive 2009/65/EC[8] of the European Parliament and of the Council,

(g) an institution for occupational retirement provision within the meaning of Article 6(a) of Directive 2003/41/EC of the European Parliament and of the Council[9],

(h) an alternative investment fund managed by AIFMs authorised or registered in accordance with Directive 2011/61/EU of the European Parliament and of the Council[10],

(i) a CCP authorised in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council[11],

(j) a central securities depositary authorised in accordance with Regulation EU No 909/2014 of the European Parliament and of the Council[12].

A third-country entity is a non-financial entity if it would not require authorisation under any of the aforementioned legislation if it was based in the Union and subject to Union law.

(1) ‘spot month contract’ means the commodity derivative contract in relation to a particular underlying commodity whose maturity is the next to expire in accordance with the rules set by the trading venue.

(2) ‘other months’ contract’ means any commodity derivative contract that is not a spot month contract.

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5 First Council Directive of 24 July 1973 on the coordination of laws regulations and administrative provisions relating to the taking up and pursuit of the business of direct insurance other than life assurance.

6 Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance.

7 Directive 2005/68/EC of the European Parliament and of the Council of 16 November 2005 on reinsurance.

8 Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

9 Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision.

10 Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers.

11 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories

12 Regulation 2014/909/EU of the European Parliament and of the Council of 23 July 2014 on on improving securities settlement in the European Union and on central securities depositories.

CHAPTER II
METHOD FOR CALCULATING THE SIZE OF THE NET POSITION OF A PERSON

Article 3
(Article 57(1) of Directive 2014/65/EU)
Aggregation and netting of positions in a commodity derivative

1. The net position of a person in a commodity derivative shall be the aggregation of its positions held in that commodity derivative traded on a trading venue, in commodity derivatives considered the same commodity derivative to that commodity derivative in accordance with paragraph 1 of Article 5, and in economically equivalent OTC contracts pursuant to Article 6.

2. Where a person holds both long and short positions in any of the commodity derivatives referred to in paragraph 1, the person shall net those positions to determine its net position for that commodity derivative.

3. Positions held by a non-financial entity in commodity derivatives that are objectively measureable as reducing risks in accordance with Article 7, as approved by the competent authority pursuant to Article 8, shall not be aggregated for the purposes of determining the net position of that non-financial entity.

4. A person shall determine separately the net position it holds in a commodity derivative for both the spot month contracts and the other months' contracts.

Article 4
(Article 57(1) of Directive 2014/65/EU)
Method of calculating positions for legal entities within a group

1. A parent undertaking shall determine its net position by aggregating the following positions in accordance with Article 3:

   (a) its own net position;

   (b) the net positions of each of its subsidiary undertakings.

2. By way of derogation to paragraph 1, the parent undertaking of a collective investment undertaking or, where the collective investment undertaking has appointed a management company, the parent undertaking of that management company shall not aggregate the positions in commodity derivatives in any collective investment undertaking where it does not in any way influence the investment decisions in respect of opening, holding or closing those positions.

Article 5
(Article 57(6) of Directive (EU) No 2014/65/EU)
Same commodity derivatives and significant volumes

1. A commodity derivative traded on a trading venue shall be considered the same commodity derivative as a commodity derivative traded on another trading venue where the following conditions are met:

   (a) both commodity derivatives have identical contractual specifications, terms and conditions, excluding post trade risk management arrangements;

(b) both commodity derivatives form a single fungible pool of open interest or, in the case of commodity derivatives defined under point (c) of Article 4(1)(44) of Directive 2014/65/EU, of securities in issue by which the positions held in a commodity derivative traded on one trading venue may be closed out against the positions held in the commodity derivative traded on the other trading venue.

2. A commodity derivative shall be considered to be traded in a significant volume on a trading venue when the trading in the commodity derivative on that trading venue over a consecutive three month period:

(a) exceeds an average daily open interest of 10,000 lots in the spot and other months' combined; or

(b) in the case of commodity derivatives defined under point (c) of Article 4(1)(44) of Directive 2014/65/EU, when the number of units traded multiplied by the price exceeds an average daily amount of 1 million EUR.

3. The trading venue where the largest volume of trading in the same commodity derivative takes place shall be the trading venue that over one year has:

(a) the largest average daily open interest; or

(b) in the case of commodity derivatives defined under point (c) of Article 4(1)(44) of Directive 2014/65/EU, the highest average daily amount.

Article 6
(Article 57(1) of Directive 2014/65/EU)
OTC contracts economically equivalent to commodity derivatives traded on trading venues

An OTC derivative shall be considered economically equivalent to a commodity derivative traded on a trading venue where it has identical contractual specifications, terms and conditions, excluding different lot size specifications, delivery dates diverging by less than one calendar day and different post trade risk management arrangements.

Article 7
(Article 57(1) of Directive 2014/65/EU)
Positions qualifying as reducing risks directly related to commercial activities

1. A position held by a non-financial entity in commodity derivatives traded on trading venues or in economically equivalent OTC contracts pursuant to Article 6 qualifies as reducing risks directly relating to the commercial activities of that non-financial entity where by itself, or in combination with other derivatives in accordance with paragraph 2 ('position in a portfolio of commodity derivatives'), the position meets one of the following criteria:

(a) it reduces the risks arising from the potential change in the value of assets, services, inputs, products, commodities or liabilities that the non-financial entity or its group owns, produces, manufactures, processes, provides, purchases, merchandises, leases, sells, or incurs or reasonably anticipates owning, producing, manufacturing, processing, providing, purchasing, merchandising, leasing, selling or incurring in the normal course of its business;

(b) it qualifies as a hedging contract pursuant to International Financial Reporting Standards (IFRS) adopted in accordance with Article 3 of Regulation (EC) No 1606/2002 of the European Parliament and Council[13].

2. For the purposes of paragraph 1, a qualifying risk-reducing position taken on its own or in combination with other derivatives is one for which the non-financial entity or the person holding the position on behalf of that entity:

(a) describes the following in its internal policies:

(i) the types of commodity derivative contracts included in the portfolios used to reduce risks directly relating to commercial activity and their eligibility criteria;

(ii) the link between the portfolio and the risks that the portfolio is mitigating;

(iii) the measures adopted to ensure that the positions concerning those contracts serve no other purpose than covering risks directly related to the commercial activities of the non-financial entity, and that any position serving a different purpose can be clearly identified;

(b) is able to provide a sufficiently disaggregated view of the portfolios in terms of class of commodity derivative, underlying commodity, time horizon and any other relevant factors.

Article 8
(Article 57(1) of Directive 2014/65/EU)
Application for the exemption from position limits

1. A non-financial entity holding a qualifying position in a commodity derivative shall apply for the exemption referred to in the second subparagraph of paragraph 1 of Article 57 of Directive 2014/65/EU to the competent authority which sets the position limit for that commodity derivative.

2. The person referred to in paragraph 1 shall submit to the competent authority the following information which demonstrates how the position reduces risks directly relating to the non-financial entity’s commercial activity:

(a) a description of the nature and value of the non-financial entity’s commercial activities in the commodity to which the commodity derivative for which an exemption is sought is relevant;

(b) a description of the nature and value of the non-financial entity’s activities in the trading of and positions held in the relevant commodity derivatives traded on trading venues and in their economically equivalent OTC contracts;

(c) a description of the nature and size of the exposures and risks in the commodity which the non-financial entity has or expects to have as a result of its commercial activities and which are or would be mitigated by the use of commodity derivatives;

(d) an explanation of how the non-financial entity’s use of commodity derivatives directly reduces its exposure and risks in its commercial activities.

13 OJ L 243, 11.9.2002, p. 1

3. The competent authority shall approve or reject the application within 21 calendar days after it has received the application and shall notify the non-financial entity of its approval or rejection of the exemption.

4. The non-financial entity shall notify the competent authority if there is a significant change to the nature or value of the non-financial entity's commercial activities or its trading activities in commodity derivatives and the change is relevant to the information set out in point (b) of paragraph 2 and shall submit a new application for the exemption if it intends to continue to use it.

CHAPTER III
METHODOLOGY FOR COMPETENT AUTHORITIES TO CALCULATE POSITION LIMITS

SECTION 1
Determination of baseline figures

Article 9
(Article 57(4) of Directive 2014/65/EU)
Methodology for determining the baseline figure for spot month limits

1. Competent authorities shall determine a baseline figure for the spot month position limit in a commodity derivative by calculating 25% of the deliverable supply for that commodity derivative.

2. The baseline figure shall be specified in lots which shall be the unit of trading used by the trading venue on which the commodity derivative trades representing a standardised quantity of the underlying commodity.

3. Where a competent authority establishes different position limits for different times within the spot month period, those position limits shall decrease on an incremental basis towards the maturity of the commodity derivative and shall take into account the position management arrangements of the trading venue.

4. By way of derogation to paragraph 1, competent authorities shall determine the baseline figure for the spot month position limit for any derivative contract with an underlying that qualifies as food intended for human consumption with a total combined open interest in spot and other months' contracts exceeding 50,000 lots over a consecutive three month period by calculating 20% of the deliverable supply in that commodity derivative.

Article 10
(Article 57(3) of Directive 2014/65/EU)
Deliverable supply

1. Competent authorities shall calculate the deliverable supply for a commodity derivative by identifying the quantity of the underlying commodity that can be used to fulfil the delivery requirements of the commodity derivative.

2. Competent authorities shall determine the deliverable supply for a commodity derivative referred to in paragraph 1 by reference to the average monthly amount of the underlying commodity available for delivery over the one year period immediately preceding the determination.

3. In order to identify the quantity of the underlying commodity meeting the conditions of paragraph 1, competent authorities shall take into account the following criteria:

(a) the storage arrangements for the underlying commodity;

(b) the factors that may affect the supply of the underlying commodity.

Article 11
(Article 57(4) of Directive 2014/65/EU)
Methodology for determining the baseline figure for other months' limits

1. Competent authorities shall determine a baseline figure for the other months' position limit in a commodity derivative by calculating 25% of the open interest in that commodity derivative.

2. The baseline figure shall be specified in lots which shall be the unit of trading used by the trading venue on which the commodity derivative trades representing a standardised quantity of the underlying commodity.

Article 12
(Article 57(3) of Directive 2014/65/EU)
Open interest

Competent authorities shall calculate the open interest in a commodity derivative by aggregating the number of lots of that commodity derivative that are outstanding on trading venues at a point in time.

Article 13
(Article 57(4) of Directive (EU) No 2014/65/EU)
Methodology for determining the baseline figure in respect of certain contracts

1. By way of derogation to Article 9, competent authorities shall determine the baseline figure for the spot month position limits for cash settled spot month contracts which are under C(10) of Annex I to Directive 2014/65/EU and which have no measurable deliverable supply of their underlying commodities by calculating 25% of the open interest in those commodity derivative contracts.

2. By way of derogation to Articles 9 and 11, competent authorities shall determine the baseline figure for the position limits for commodity derivatives defined under point (c) of Article 4(1)(44) of Directive 2014/65/EU by calculating 25% of the number of securities issued. The baseline figure shall be specified in number of securities.

3. By way of derogation to Articles 9 and 11, where a commodity derivative provides that the underlying is delivered constantly over a specified period of time, the baseline figures calculated pursuant to Articles 9 and 11 shall apply to related commodity derivatives for the same underlying to the extent that their delivery periods overlap. The baseline figure shall be specified in units of the underlying.

SECTION II
Factors relevant for the calculation of position limits

Article 14
(Article 57(3) of Directive 2014/65/EU)
Assessment of factors

Competent authorities shall set the spot month and other months' position limits for a commodity derivative by taking the baseline figure determined in accordance with Articles 9, 11 and 13 and adjusting it according to the potential impact of the factors referred to in Articles 16 to 20 on the integrity of the market for that derivative and for its underlying commodity to a limit:

(a) between 5% and 35%; or

(b) between 2.5% and 35%, for any derivative contract with an underlying that qualifies as food intended for human consumption with a total combined open interest in spot and other months' contracts exceeding 50,000 lots over a consecutive three month period.

Article 15
(Article 57(3)(g) of Directive 2014/65/EU)
New and illiquid contracts

1. By way of derogation to Article 14,

   (a) for commodity derivatives traded on a trading venue with a total combined open interest in spot and other months' contracts not exceeding 10,000 lots over a consecutive three month period, competent authorities shall set the limit of positions held in those commodity derivatives at 2,500 lots;

   (b) for commodity derivatives traded on a trading venue with a total combined open interest in spot and other months' contracts in excess of 10,000 but not exceeding 20,000 lots over a consecutive three month period, competent authorities shall set the spot and other months' position limit between 5% and 40%;

   (c) for commodity derivatives as defined in point (c) of Article 4(1)(44) of Directive 2014/65/EU with a total number of securities in issue not exceeding 10 million over a consecutive three month period, the competent authority shall set the limit of positions held in those commodity derivatives at 2.5 million securities;

   (d) for commodity derivatives as defined in point (c) of Article 4(1)(44) of Directive 2014/65/EU with a total number of securities in issue in excess of 10 million but not exceeding 20 million over a consecutive three month period, the competent authority shall set the spot and other months' position limit between 5% and 40%.

2. The trading venue shall notify the competent authority when the total open interest of any such commodity derivative reaches any of the amounts of lots or number of securities in issue mentioned in the previous paragraph over a consecutive three month period. Competent authorities shall review the position limit upon receiving such notifications.

Article 16
(Article 57(3)(a) of Directive 2014/65/EU)
The maturity of the commodity derivatives contracts

1. For spot month position limits, if the commodity derivative has a short maturity, competent authorities shall adjust the position limit downwards.

2. For other months' position limits, where the commodity derivative has a large number of separate expiries, competent authorities shall adjust the position limit upwards.

Article 17
(Article 57(3)(b) of Directive 2014/65/EU)
Deliverable supply in the underlying commodity

Where the deliverable supply in the underlying commodity can be restricted or controlled or if the level of deliverable supply is low relative to the amount required for orderly settlement competent authorities shall adjust the position limit downwards. Competent authorities shall assess the extent to which this deliverable supply is used also as the deliverable supply for other commodity derivatives.

Article 18
(Article 57(3)(c) of Directive 2014/65/EU)
The overall open interest

1. Where there is a large volume of overall open interest, competent authorities shall adjust the position limit downwards.

2. Where the open interest is significantly higher than the deliverable supply, competent authorities shall adjust the position limit downwards.

3. Where the open interest is significantly lower than the deliverable supply, competent authorities shall adjust the position limit upwards.

Article 19
(Article 57(3)(e) of Directive 2014/65/EU)
The number of market participants

1. Where the daily average number of market participants holding a position in the commodity derivative over a period of one year is high the competent authority shall adjust the position limit downwards.

2. By way of derogation to Article 14, competent authorities shall set the spot month and other months' position limit between 5% and 50% if:

   (a) the average number of market participants holding a position in the commodity derivative in the period leading up to the setting of the position limit is lower than 10; or

   (b) the number of investment firms acting as a market maker in accordance with Article 4(1)(7) of Directive 2014/65/EU in the commodity derivative at the time the position limit is set or reviewed is lower than 3.

   For the purposes of the first subparagraph, competent authorities may establish different position limits for different times within the spot month period, the other months' period or for both periods.

Article 20
(Article 57(3)(f) of Directive 2014/65/EU)
Characteristics of the underlying commodity market

1. Competent authorities shall take into account how the characteristics of the underlying market impact on the functioning and trading of the commodity derivative and on the size of the positions held by market participants, including having regard to the ease and speed of access which market participants have to the underlying commodity.

2. The assessment of the underlying commodity market referred to in paragraph 1 shall take into account:

   (a) whether there are restrictions on the supply of the commodity, including the perishability of the deliverable commodity;

   (b) the method of transportation and delivery of the physical commodity, including the following:

      (i) whether the commodity can be delivered to specified delivery points only;

      (ii) the capacity constraints of specified delivery points.

   (c) the structure, organisation and the operation of the market, including the seasonality present in extractive and agricultural commodity markets whereby physical supply fluctuates over the calendar year;

   (d) the composition and role of market participants in the underlying commodity market, including consideration of the number of market participants which provide specific services that enable the functioning of the underlying commodity market such as risk management, delivery, storage, or settlement services;

   (e) macroeconomic or other related factors that influence the operation of the underlying commodity market including the delivery, storage, and settlement of the commodity;

   (f) the characteristics, physical properties and lifecycles of the underlying commodity.

Article 21
(Article 57(3)(d)) of Directive 2014/65/EU)
Volatility of the relevant markets

After having applied the factors referred to in Articles 16 to 20 which are relevant to set the position limit for each contract in commodity derivatives referred to in Article 57(4) of Directive 2014/65, competent authorities shall further adjust that position limit where the following conditions are met:

(a) there is excessive volatility in the price of commodity derivative or in the underlying commodity;

(b) a further adjustment of the position limit would effectively reduce the excessive volatility in the price of that commodity derivative or in the underlying commodity.

Article 22
Entry into force and application

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

It shall apply from 3 January 2017.

Done at Brussels, 1.12.2016

For the Commission
The President
Jean-Claude JUNCKER