Position reporting, position management and current ESMA work on commodity derivatives

Brussels, 15 March 2017
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➔ Position reporting
➔ Position management powers
➔ ESMA works in the course of 2017
Overview of reporting obligations under MiFID II/MAR

Commitment of traders report - TRANSPARENCY

- Article 58 MiFID II: Transparency to the market about the view of the market that certain categories of traders may be taking

Position reports – POSITION LIMITS

- Article 58 MiFID II: Monitoring and supporting position limits under Article 57 MiFID II (prevention of market abuse and market distorting position)

Transaction reporting – MARKET ABUSE

Prevention of Market Abuse ➔ Article 26 MiFIR: obligation of investment firms to report all transactions on commodity derivatives traded on a trading venue; whose underlying is traded on a trading venue; whose underlying is composed of financial instruments traded on a trading venue

Suspicious transactions report - MARKET ABUSE

Prevention of Market Abuse ➔ Article 16 MAR:
- Trading venues should have arrangements to prevent and detect insider dealing, market manipulation
- Persons professionally arranging or executing transactions should have arrangements to detect and report suspicious orders and transactions
WHAT IS A POSITION LIMIT?

**Position limit:** Maximum net position which a person can hold at all times in commodity derivatives traded on trading venues and economically equivalent OTC contracts (EEOTC).

- **Objective:** Prevent market abuse and support orderly pricing and settlement.

- **Calculation:** All positions held by a person and those held on his behalf at an aggregate group level should be aggregated and netted off (unless no control).

- **Exemption:** Positions held by or on behalf of a non-financial entity used for hedging (“objectively measurable as reducing risks directly relating to the commercial activity”) should not be counted.

( Art 57(1) of MIFID II, Rec (4),(8) of RTS 21 )
HOW IS A POSITION CALCULATED?

Aggregation and netting of long and short positions

commodity derivative traded on trading venue A

the “same” commodity derivative traded on trading venues B, C...

EEOTCs

NFC hedging exemption

“Single fungible pool of open interest / positions held in one venue can be closed out against the positions held on the other venue”

and

“Identical contractual specifications, terms and conditions ex lot size, delivery dates (<1 day) and post-trade risk arrangement”

“Identical contractual specifications, terms and conditions ex post-trade risk arrangement”

[Art 57(4),(6) of MIFID II, Art 5(1), 6 of RTS 21]
Position reporting: overview

Centralised publication by ESMA

Commitment of Trader Reports

Aggregated weekly reports

Trading venues (regulated markets, multilateral trading facilities and organised trading facilities)

Central NCA

Reports to NCA

IF A trading OTC

IF B trading OTC

IF C trading OTC

IF D trading OTC
Position reporting: on venue trading

Trading venue

Publicly available
Weekly
Aggregate long and short positions held by:
- Investment firms and credit institutions
- Investment funds or alternative funds
- Other financial institutions
- Commercial undertakings
Any changes thereto since the previous report, percent of total open interest represented by each category and number of persons in each category.

Daily
Breakdown of all positions held by the members or participants (IFs) and their clients and the clients of their clients until the end client is reached.

Centralised publication of all weekly position reports by ESMA

Members/participants/clients of RMs, MTFs, OTFs report daily their own positions, their clients’ and the clients of their clients’ till the end client is reached.

Reported to NCAs

Central NCA

Not publicly available.
Position reporting: OTC trading

At least on a daily basis a complete breakdown of their positions and those of their clients reaching the end client including:
- On-venue trading
- Economically equivalent OTC trades

Central NCA

NCA OF THE MARKET WHERE THE COMMODITY DERIVATIVE IS TRADED

Investment firms trading OTC
Investment firms trading OTC
Investment firms trading OTC
Investment firms trading OTC
Investment firms trading OTC
Position reporting differentiates financial and non-financial related activities and maturity

**Position Report from IF to NCA**
- Positions which in an objectively measurable way reduce risks relating to commercial activities
  - Other positions
  - Spot month
  - Other months

**Position Report from IF to trading venue**
- Positions which in an objectively measurable way reduce risks relating to commercial activities
  - Other positions
  - Spot month
  - Other months

**Commitment of Traders Report**
- Positions which in an objectively measurable way reduce risks relating to commercial activities
  - Other positions
  - Spot month
  - Other months

Percentage of the total open interest represented by each category of traders
Positions which in an objectively measurable way reduce risks relating to commercial activities

These are positions in commodity derivatives or EEOTC for which position limits do not apply (Article 57.1 MiFID II)

To be considered as a non-financial entity: commercial firm notifies annually the NCA.

To justify to the NCA upon request the basis for that assessment.

To exempt qualifying positions from PL regime in one commodity derivative: application to the NCA setting the PL in that derivative + demonstration that those positions:
- Reduce the risks directly relating to the commercial activity; or 'hedging' contract under IFRS
- Described in the internal policies of the commercial entity
- A sufficiently disaggregated view can be provided

Identify these hedging positions as such in all the reports

Article 2.4 MiFID II + Article 5 RTS 20

Article 57 MiFID II + Article 7 and 8 RTS 21
Position reporting: issues on reporting for PL purpose

- Obligation of investment firms to report the ‘positions of their client and the clients of their clients until the end client is reached’.

- Should ALL OTC trades in commodity derivatives be reported under Article 58(2)? No. Only OTC trades of commodity derivatives traded on-exchange and EEOTC commodity derivatives.

- Is a non-financial entity (e.g. a producer) entering into an OTC commodity derivative obliged to report under Article 58(2)? No, only investment firms.
Position reporting: issues on reporting for transparency purposes

Are all commodity derivatives traded on-exchange subject to position reporting (for transparency purposes)? No.

Only when both of the following two thresholds are met:

- 20 open position holders exist in a given contract on a given trading venue; and
- the absolute amount of the gross long or short volume of total open interest, expressed in the number of lots of the relevant commodity derivative, exceeds a level of four times the deliverable supply in the same commodity derivative, expressed in number of lots.
### Extraordinary situations: position management controls and position management powers

<table>
<thead>
<tr>
<th>Article 57.8 MiFID II: trading venues</th>
<th>Article 69.2 MiFID II: national competent authorities</th>
<th>ESMA: Article 45 MiFIR</th>
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<tr>
<td>- <strong>Monitor</strong> the open interest positions</td>
<td>(o) Request any person to take steps to reduce the size of the position or exposure [not only commodity derivatives]</td>
<td>- Request from any person all relevant information regarding the size and purpose of position/exposure entered into via a derivative</td>
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<td>- <strong>Access all relevant information</strong> on size and purpose of a position/beneficial or underlying owners/concert arrangements/</td>
<td>(p) Limit the ability of any person from entering into a commodity derivative, including by introducing limits on the size of a position any person can hold at all times (Position limits)</td>
<td>- Requiring any person to reduce the size or eliminate the position</td>
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<td>- <strong>Require a person to terminate or reduce a position, on a temporary or permanent basis</strong> and to unilaterally take action to ensure that in case of non-compliance.</td>
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<td>- As a last resort, limit the ability of a person from entering into a commodity derivative</td>
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<td>- Where appropriate, require the person to <strong>bring liquidity back</strong> into the market at an agreed price and volume on a temporary basis</td>
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NCAS may request any person to reduce the size of a position or exposure and limit the capacity to enter into a commodity derivative. ESMA to ensure consistent approach and publish information about the measures taken by NCAs. In the absence of reaction from NCA to a threat to the markets, ESMA may act. NCA has sufficient regulatory powers to fully address the threat but does not take action. The disruption affects several jurisdictions so the isolated action of one NCA would not solve the issue.

 Threat to the functioning and integrity of the market
What has to happen so that ESMA makes use of its position management powers?

- Do not affect the efficiency of financial markets (reduction of liquidity, restraining hedging capacity...)
- Do not create a risk of regulatory arbitrage
- ESMA has to consult previously the public bodies competent for the oversight, administration and regulation of physical agricultural markets (all of them) or ACER (for wholesale energy products)
- The measures address a threat to the orderly functioning of the market
- BUT...
- The majority of NCAs sitting at its Board have to agree.
LINES OF WORK OF ESMA

Phases:

- **Technical advice to COM** (delivered in December 2014)
- **Regulatory technical standards** on position limits and ancillary activity (two rounds of consultation, delivered in September 2015)
- **Implementing technical standards** on position reporting (December 2015)

**Pre-implementation phase** (January 2016-to date):

- ESMA’s Opinions to the rejected COM standards (May 2016)
- Revision of ITS 4 in light of practical implementation problems
- Collection of questions and elaboration of responses [publication delayed until COM’s endorsement of their own versions of RTS 20 and 21] (ongoing)
- Review of position limits in liquid and relatively liquid commodity derivatives in the course of 2017 (publication expected before the end of 2017)
POSITION LIMITS: WHAT IS THE ROLE OF ESMA?

**Opinion:** ESMA shall issue an opinion on whether the NCA followed correctly the methodology in setting the limits. The timeline is 2 months from receipt of notification.

**Content:** The opinion should assess the compatibility of position limits with:
- the objectives (“prevent market abuse and support orderly pricing and settlement”), and
- the methodology (i.e. the parameters set out in RTS 21 to be taken into account).

**Review:** ESMA should also monitor at least yearly the implementation of position limits.

The current estimates from NCAs indicate that there should be around **35 agricultural products** subject to individual analysis. Illiquid instruments subject to the limits set out in RTS 21.
Thank you