

EVIA & LEBA Response to ESMA Consultation Paper; Technical Standards for Commodity Derivatives

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Page 1

ESMA will consider all comments received by 23 July 2021

General Comments

The members of the European Venues and Intermediaries Association and the London Energy Brokers Association operate MTFs and OTFs across several EU member states which admit a range of commodity and energy forward contracts. Whilst many of these “physical forwards” benefit from the exemptive relief provided for under PERG C6, this does not cover all physical forwards. Of the non-exempt instruments, some are CCP cleared by third party CCPs and others are uncleared.

There is some duality or overlap of reporting and post-trade obligations between each of MiFID2, REMIT and EMIR which disbenefit from different definitions and terminology.

In considering the review of the technical standards stemming from changes to MiFID2 in the Capital Markets Recovery Package adopted by the co-legislators in December 2020 and published in the Official Journal on 26 February 2021; we would like to draw attention to the requirements for Trading Venues to submit position reports for uncleared derivatives and for physical forwards.

As ESMA are aware, MTFs/OTFs do not operate as vertical exchanges and have no sight of the CCP clearing operation for those contracts which are cleared, whilst most derivatives which they admit are anyway physically delivered forwards, usually traded as spreads, options and packages. Therefore no “Open Interest” is generated. Rather the forward positions are incorporated in the counterparties’ balance sheets and subject to margin according to the contract details and the appropriate capital treatment.

Whilst the majority of contracts arranged and executed by member MTFs and OTFs fall under the PERG C6 exemptions and are therefore out of scope of most of the rules under consideration in this paper, that is by no means all of them. Indeed, ESMA has stipulated that no MiFID MTF / OTF can be in the position of solely admitting contracts covered by relevant PERG exemptions, C6, C7 and C10.

To date under MiFID2, NCAs have therefore not required position reporting to be made by MTFs and OTFs (as they have no sight of the participants’ open positions and also the contracts can concatenate and are fungible and transportable and often also combustible.)

“RTS21a” & “ITS4” - Scope and applicability:

1. Is there a simple exemption for non-cleared commodity derivatives from position reporting?

2. Do we interpret the exemption from the [Art 83 rule](#) (which is based on 20 open position holders exist on the TV...) to negate the requirement for "Open Interest" reporting?
3. Are there broader waivers by the NCAs so that TVs have not just ended up adding daily trading volumes ?
4. Could this CP be a revision opportunity need to address this rather better than recital 18 which is anyway unclear to that point?
5. Where does ESMA consider the balance of Level1 Articles versus Level 2 technical standards or any derogation to harmonised guidance should exist on this matter?

Questions

Part I

Q1: Do you agree with ESMA's proposal regarding the impact of the new hedging exemption on the aggregation of positions? If not, please elaborate.

Yes, EVIA/LEBA considers these new hedging exemptions to be appropriate.

Q2: Do you agree with ESMA's proposal for positions qualifying as risk-reducing? If not, please elaborate and provide an alternative proposal.

Yes, EVIA/LEBA considers these wider qualifications for positions to qualify as risk-reducing to be appropriate because this now more closely approaches the effect of the "commercial purposes" implementation of MiFID 1.

Q3: Do you agree with ESMA's proposal on the application procedure for financial entities?? If not, please elaborate and provide an alternative proposal.

Whilst, EVIA/LEBA notes the intent, a simpler self-attestation, and one applying across a broader sub asset class would provide a better premise for the technical standard to be harmonised across the EU and made comparable without. NCAs shall always hold the capacity to make more detailed or thematic investigations.

Q4: Do you agree with ESMA's proposal on the application procedure for mandatory liquidity provision exemption? If not, please elaborate and provide an alternative proposal.

Yes, EVIA/LEBA agrees with these provisions, but notes that we have never yet witnessed any "mandatory liquidity provision onto trading venues" in a meaningful sense, whether in commodities or more broadly. Rather market making schemes are more flexible over longer defined periods of time and hold many caveats. Therefore, the application language should perhaps be altered to align with the schemes offered by the trading venues.

Q5: Do you agree with ESMA's proposal on qualifying positions? If not, please elaborate and provide an alternative proposal.

No EVIA/LEBA disagrees. ESMA's proposal on qualifying positions pre-supposes a non-competitive world of only CCP cleared contracts. Clearly this is far from the case for

commodity derivatives markets in the EU. Therefore paragraphs [35] & [36] should be altered to specify only CCP cleared derivative contracts.

Q6: Do you agree with ESMA's proposed definition of financial entities? If not, please elaborate.

No comment as our members are trading venues.

Q7: Do you agree with ESMA's proposal regarding the aggregation and netting of positions in a commodity derivative? If not, please elaborate and provide an alternative proposal.

No EVIA/LEBA disagrees because, following from our general comments, because ESMA's proposal needs to either be specific towards those commodity derivatives that are novated into a CCP and therefore create Open Interest, or ESMA needs to clarify its definition of commodity derivatives such that they solely include CCP cleared contracts. Clearly physical forward positions may be known, quantified and reported by the end user on a daily basis; but no trading venue could have any knowledge of the end user's risk positions.

Currently therefore a quasi-version of duplicative transaction reporting occurs which takes no account of subsequent netting, shipping, sales or onwards processing of the delivered commodities. Clearly it is equally true that any concept of spread positions in fungible commodity forwards does not make sense in the proposed regime, where legs may be netted or onwards transacted or otherwise subject to any lifecycle event.

Q8: Do you agree with ESMA's proposal for significant volumes? If not, please elaborate.

No EVIA/LEBA disagrees because, following from our comments above, ESMA's proposal needs to either be specific towards those agricultural commodity derivatives that are novated into a CCP and therefore create "Open Interest",

Q9: Do you agree with ESMA's proposal? If not, please elaborate and provide an alternative proposal where available.

No EVIA/LEBA disagrees because, following from our general comments, because ESMA's proposal needs to either be specific towards those commodity derivatives that are novated into a CCP and therefore create Open Interest, or ESMA needs to clarify its definition of commodity derivatives such that they solely include CCP cleared contracts.

Q10: Do you agree with ESMA's proposal? If not, please elaborate.

Yes, EVIA/LEBA agrees with the approach towards deliverable supply.

Q11: Do you agree with ESMA's proposals regarding Article 14 of RTS 21a? If not, please elaborate and provide alternative proposals.

No EVIA/LEBA disagrees because our members' MTF and OTF trading venues are not vertically integrated into CCP Clearing Houses. Some forwards are cleared, whilst others are physically delivered. Noting also that ESMA has only this week disapplied the MiFID2 protections to ensure "open access". ESMA's approach disregards those commodity derivatives which are not exempt under the first leg of PERG C6.

Following from our previous comments, because ESMA's proposal needs to either be specific towards those commodity derivatives that are novated into a CCP and therefore create Open Interest, or ESMA needs to clarify its definition of commodity derivatives such that they solely include CCP cleared contracts.

The outcome from ESMA's approach is to encourage multilateral trading to be characterised as "Off Venue," to be traded outside the EU, or to be traded under singular exchange rules creating an absence of competition, a failure to innovate, singular systematic risk and high-priced traded data under IPR protections.

Q12: Do you see merit in the new approach considered by ESMA for new and less liquid agricultural commodity derivatives? If not, please elaborate and provide an alternative proposal.

No comment.

Q13: Do you agree with ESMA's proposal regarding Article 19 of RTS 21a? If not, please elaborate.

No EVIA/LEBA disagrees because, following from our general comments, because ESMA's proposal needs to either be specific towards those commodity derivatives that are novated into a CCP and therefore create Open Interest, or ESMA needs to clarify its definition of commodity derivatives such that they solely include CCP cleared contracts.

Q14: Do you agree with ESMA's proposal regarding the upward adjustment factor to be used in case of a small number of market participants or less than three investment firms acting as market makers? If not, please elaborate and provide an alternative proposal.

No EVIA/LEBA disagrees because the proposal should be constrained to only those contracts admitted solely to an RM which specify CCP Clearing in their definitions. We also note that the application of the term "Spot Month" does not correspond to the use of that term in other regulations, notably REMIT; and it has an attenuated meaning for physical forward contracts.

Part II

Q15: Do you agree with ESMA's proposed amendments to ITS 4? If not, please elaborate.

No EVIA/LEBA disagrees because the proposal should be constrained to only those contracts admitted solely to an RM which specify CCP Clearing in their definitions. Physical forwards which are not subject to the exemptions under PERG C6 and C7 have no "Open Interest."

Part III

Q16: Do you agree with ESMA's suggestion to introduce such ongoing position monitoring requirement in the draft RTS? If not, please elaborate.

No EVIA/LEBA disagrees because the proposal should be constrained to only those contracts admitted solely to an RM which specify CCP Clearing in their definitions. Physical forwards which are not subject to the exemptions under PERG C6 and C7 have no sight of the positions resulting from trading on the MTF / OTF nor do they hold any "Open Interest."

Q17: Do you agree with ESMA's suggestion to introduce accountability levels as part of position management controls? Do you agree with ESMA's assessment that accountability levels would be of particular relevance for physically settled commodity derivatives? If not, please elaborate and provide alternative proposals.

No EVIA/LEBA disagrees because the suggestion to introduce accountability levels should be constrained to only those contracts admitted solely to an RM which specify CCP Clearing in their definitions. Physical forwards which are not subject to the exemptions under PERG C6 and C7 have no sight of the positions resulting from trading on the MTF / OTF nor do they hold any "Open Interest."

Q18: In your view, how should accountability levels be set for the spot month and the other months? Based on which methodology or criteria? Should all types of positions count towards the accountability levels?

See answer to Q17.

Q19: Do you agree with ESMA's suggestion to introduce requirements for the review of accountability levels? Do you also agree with ESMA's proposal regarding reporting requirements to the NCA on accountability levels? If not, please elaborate.

See answer to Q17.

Q20: In your view, what other types of position management controls could be further specified in the draft RTS?

For commodity derivatives that are not CCP Cleared by an EU CCP, EVIA/LEBA believes that the current transaction reporting regime provides all the necessary information to NCAs and that no TV approach to position management controls is feasible. Furthermore, there may be duplicative procedures under both EMIR and REMIT which again should constitute grounds for the disapplication of any MiFID requirements beyond the conduct of business and orderly markets requirements.