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MiFID II – Position Limits on Commodity Derivatives

Expert Group on agricultural commodity derivatives and spot markets, 15th March 2017

MiFID II

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Goals:

- To prevent market abuse and
- support orderly pricing and settlement conditions.

Instrument:

Application of position limits to commodity derivatives and economically equivalent derivatives by Articles 57, 58 of Dir. 2014/65/EU (MiFID II). RTS 21 has been consented by KOM and EP. In view of some MEPs regulation is too soft, particularly with respect to food.

→ Thus, increased awareness of politics and NGOs.

Time Schedule:

Implementation into national law, taking effect from 03.01.2018 on.

Commodity Derivatives

Commodity Derivatives are derivatives on

- commodities, energy, climatic variables etc. as underlyings,

in the form of Futures, Options, Swaps and Securitised derivatives

and

- Economically equivalent OTC-contracts.

⇒ Most hedging instruments for agricultural products affected!

Scope

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- Position limits do apply to every natural person and corporate entity holding commodity derivatives within the EU.
- Hence, position limits do also apply to third country counterparties who entered into contracts on EU venues or trade through investment firms seated in the EU.
  - Treatment of positions on Third Country Venues not entirely clear yet.
    - EU-investment firms may be required to report positions, even if they are trading EEOTC-contracts of third country clients and even if the bulk of trading is done on third-county venues.

Commodity Derivative

- The commodity derivative to which the position limit applies is a type of contract that is
  - traded on a trading venue

or

  - considered an economically equivalent OTC-contract.

➡ Non-economically-equivalent OTC-contracts are not covered.

- The position limit applies to the net position which is
  - the Balance of long and short positions of
  - a person or at group level.

Relevant Time Frame

As every contract is comprised of a series of contracts of different maturities we differentiate between:

- One Limit to the contract with the maturity next to expire („spot-month")
- A limit to any other contract that is not spot month contract („other months").

Relevant Underlying

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- Spot month limit is calculated by identifying deliverable supply (quantity of underlying that can be used to fulfil delivery requirements)
  - Common standards for setting deliverable supply exist

  But: Finally, delivable supply will be set by NCAs!
- Other months limit is calculated by identifying open interest on trading venue (aggregated number of lots that are outstanding)

Hedge-Exemption

- Non financial entities can apply for an exemption of positions that are reducing risks directly relating to the commercial activity of that non financial entity.

  Netting is not possible anymore with exempted positions.

- Application to Central Competent Authority, i.e. authority of jurisdiction in which relevant trading venue is located. Details of requirements and application process will be dealt with by national legislator.

Calculating Position Limits

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- Definition of position limit:

Position limit is the highest long/short position a person may hold during the validity period of the position limit.

- NCA sets the limit once a year within a range of 5% - 35% of deliverable supply/open interest, depending on
  - Liquiditity, number of market participants, storage capacity etc.
- For agricultural contracts limit can be lowered to 2,5%, general limit is at 20%!

Weekly Report

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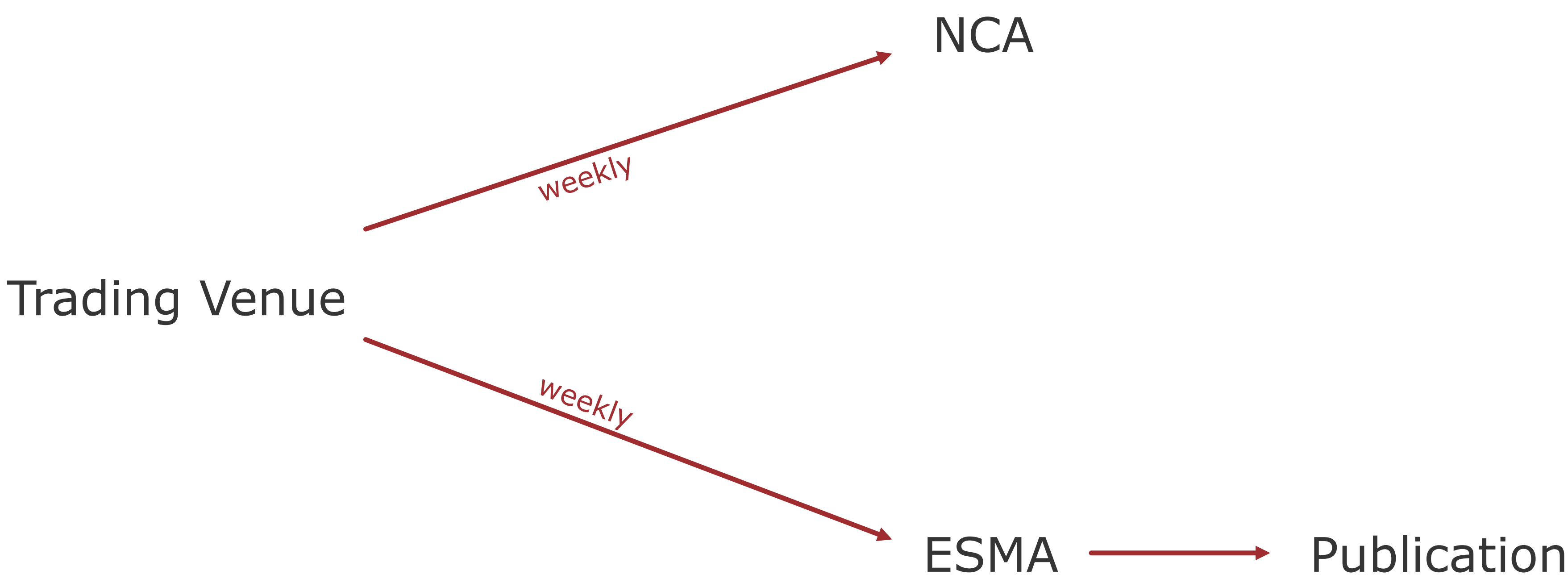

Daily Reporting at Trading Venues

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$$\text{End client} \xrightarrow{\text{daily}} \text{Intermediary} \xrightarrow{\text{daily}} \text{Broker} \xrightarrow{\text{daily}} \text{Trading Venue} \xrightarrow{\text{daily}} \text{NCA} \xleftrightarrow{\text{Exchange with CCA}} \text{CCA}$$

Daily Reporting OTC

End client $\xrightarrow{\text{daily}}$ Financial Intermediary $\xrightarrow{\text{daily}}$ Investment firm $\xrightarrow{\text{daily}}$ NCA / CCA

End client is the first NFC in the chain!

Thank you for your attention!