Europex

Response to ESMA MiFID II/MiFIR Consultation Paper Nr. 2

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Q Nr	Question	Draft response
Q168	**Do you agree with the approach suggested by ESMA in relation to the overall application of the thresholds? If you do not agree please provide reasons.**	Europex broadly agrees with ESMA's approach but would like to highlight a few specific aspects in order to help further improve the suggested methodology: **(1) Europex does not share ESMA's view that the ancillary activity test and the trading activity test should be met both in order for an entity to qualify for the ancillary activity exemption** Europex, on the contrary, deems appropriate that those tests must both be **failed in order** for an entity to be required to obtain a MiFID license. We understand that this is in line with the Level 1 text and the mandate given to ESMA by the Commission. The mandate indeed explicitly asks ESMA to elaborate a methodology where both the ancillary nature and the trading size of the activity are taken into account in order to determine whether a firm should be captured by the scope of MiFID II or not. **(2) The risk reducing effect of central clearing by Central Counterparties (CCPs) should be reflected in the determination of the ancillary activity tests** Europex suggests that commodity and emission allowances derivatives that are traded on Regulated Markets (RMs) should only count towards the ancillary activity thresholds in a risk-adjusted manner. Indeed, the significant narrowing of the MiFID I exemptions in MiFID II aims primarily at mitigating systemic risk. Yet, contracts traded on regulated markets are systematically centrally cleared and do thus not pose the same level of systemic risk as non-cleared contracts that are traded on other platforms. This aspect is taken into account by the European Market Infrastructure Regulation (EMIR). Under EMIR, exchange-traded and centrally cleared derivatives (ETDs) do not count towards the clearing threshold. When a derivative is centrally cleared, the counterparty risk arising from the transaction is managed by the CCP. The risk to cover an open position of a clearing member in the event of a default is *inter alia* captured by the initial margin provided by the clearing member. In this context, the initial margin corresponds to the default risk in case of a cleared contract. The value of the initial margin can vary depending on the contract as it depends on the contract volatility. In gas and power derivative markets, initial margins do not exceed 15%. Europex therefore suggests that the capital employed for carrying out the ancillary activity should be measured via the

		initial margin in relation to contracts traded on a RM. Therefore, an exchange-traded contract would be considered with 15% compared to an OTC-derivative with similar characteristics which is not cleared. This would better reflect both the actual capital employed by the market participants as well as the risk structure of cleared contracts. **Weighing the RM traded contracts with a risk-adjusted method would result in taking into account 15 percent of the costs of each contract traded on Regulated Markets in the calculation of the ancillary activity** tests. This would: (a) incentivise non-financial firms to trade in exchange traded (under the scope of MiFID II), cleared products (under the scope of EMIR). The proposal would therefore incentivise a shift in trading activity towards regulated trading venues and would thereby reduce counterparty risk and systemic risk in European wholesale commodity markets. (b) be in line with the G-20 Pittsburgh commitments of promoting more transparent, non-discriminatory and systemically safer markets and the specific aims of the MiFID review of preventing market abuse, systemic risk and achieving a level playing field. Besides, it should be taken into account that Regulated Markets already impose high requirements on their members, being financial entities or not: • Mandatory clearing imposed on every contract traded on the RM, • Full pre- and post trade transparency, • Testing of algorithmic trading, • Capital requirements for clearing purposes, • Organisational requirements on trading companies, • Supervision of the trading activity of the member. <u>These requirements are comparable to those imposed on MiFID II licensed entities. Exactly as MiFID II licensed activities are excluded from the ancillary activity calculation, transactions concluded on RMs could be weighed proportionately.</u> **(3) Europex does not share the view that for each asset class the same thresholds should apply.**

This is based on the following reasons:

- Regarding the ancillary activity test, Europex shares the view that only business activities in the EU should be taken into account, and that these activities should be put in relation to global business at group level. However, this creates a disadvantage for firms that are only active within the EU. As for grid bound commodities like power and gas, the firms' activity is naturally concentrated at EU level. Europex assumes that the thresholds for both the ancillary activity test and the trading activity test have been lowered by ESMA due to the adoption of the "EU-business/worldwide activities" approach. Though, Europex notes that small gas and power trading firms do not benefit from the "EU-business/worldwide activities" approach, since they only have activity in the EU and therefore are adversely affected by the lower thresholds as suggested.
- Considering gas and power, Europex does clearly not deem a threshold of 5% appropriate for the first test. If it was applied at the suggested level of 5%, it would seriously harm energy trading in Europe with far reaching negative consequences for market liquidity, transparency and the further integration of the EU internal energy market. Given the direct linkage of MiFID II to the applicability of CRD IV, a large majority of real economy companies, including e.g. small and medium-sized utilities, would have to become MiFID investments firms and meet considerably higher capital requirements than today. In consequence, many companies would not be able to cope with the cost increase and may either largely reduce their trading activity or shift it to OTF platforms. Thus, wholesale gas and power wholesale markets would become fragmented and the EMIR framework would be undermined.
- As far as gas and power are concerned, a specific exemption is foreseen in Annex I C (6). REMIT wholesale products that are derivatives, traded on an OTF and "that must be physically settled" are not considered financial instruments. Therefore, neither MiFID II nor EMIR does apply. The C6 exemption as such creates incentives to shift liquidity away from RMs and MTFs to OTFs as can be already observed today where non-MTFs attract liquidity. Low thresholds of the ancillary activity exemption would further boost these incentives. In order to keep a level playing field between RMs, MTFs and OTFs and to keep a significant share of traded gas and power contracts within the MiFID II and EMIR frameworks, the thresholds should be defined proportionally.

  In case of no further changes to the suggested thresholds, Europex expects the following: Regarding gas and power trading, firms will be exempted from MiFID II because of the C6 carve out. The design of the ancillary activity exemption and the definition of the thresholds therefore will not put a cap on companies that are exempted from MiFID II. On the contrary, it will rather determine the shares of contracts that will be traded on RMs, MTFs and OTFs, and thus the applicability of MiFID II and EMIR to gas and power derivatives trading.

Q169	**Do you agree with ESMA's approach to include non-EU activities with regard to the scope of the main business?**	Yes, Europex agrees. However, we would like to point out that this approach greatly disadvantages firms without non-EU activities. This relates in particular to firms whose main business is based on grid bound commodities, an activity which naturally local and regional. The threshold should thus not be lowered because non-EU activities are taken into account. This is especially true for small and medium-sized firms which will not benefit from this widening of the scope of activities for the threshold calculation.
Q170	**Do you consider the revised method of calculation for the first test (i.e. capital employed for ancillary activity relative to capital employed for main business) as being appropriate? Please provide reasons if you do not agree with the revised approach.**	Yes, Europex agrees.
Q171	**With regard to trading activity undertaken by a MiFID licensed subsidiary of the group, do you agree that this activity should be deducted from the ancillary activity (i.e. the numerator)?**	Yes, Europex agrees.
Q172	**ESMA suggests that in relation to the ancillary activity (numerator) the calculation should be done on the basis of the group rather than on the basis of the person. What are**	• Europex welcomes the approach to calculate the ancillary activity at group level and not person by person. This does not only allow for an easier implementation of MiFID II/MiFIR by the concerned companies and by the national competent authorities alike. It also reflects the actual activity and the dealing in financial instruments of those companies much better. Given the oftentimes complex organisational structure of historically grown firms due to regional and international engagements and other reasons, a more fragmented approach would eventually risk

	the advantages or disadvantages in relation to this approach? Do you think that it would be preferable to do the calculation on the basis of the person? Please provide reasons. (Please note that altering the suggested approach may also have an impact on the threshold suggested further below).	undermining the ancillary activity exemption as such. • It needs to be clarified which entity of a group and under which circumstances requires a license. For instance, if the calculation is done at group-level and if the threshold is exceeded, it will be unclear which entity needs to apply for a license. If the calculation is done based on persons, we understand that only persons exceeding the threshold need to apply for a MiFID license.
Q173	**Do you consider that a threshold of 5% in relation to the first test is appropriate? Please provide reasons and alternative proposals if you do not agree.**	(1)Considering gas and power, Europex does clearly not deem a threshold of 5% appropriate for the first test. If it was applied at the suggested level of 5%, it would seriously harm energy trading in Europe with far reaching negative consequences for market liquidity, transparency and the further integration of the EU internal energy market. Given the direct linkage of MiFID II to the applicability of CRD IV, a large majority of real economy companies, including e.g. small and medium-sized utilities, would have to become MiFID investments firms and meet considerably higher capital requirements than today. In consequence, many companies would not be able to cope with the cost increase and may either largely reduce their trading activity or shift it to OTF platforms. If the thresholds remained as low as currently proposed, Europex would not rule out a situation where the total traded market could shrink to one in which only physical consumption volumes will be hedged (churn ratio of 1). Lower wholesale market liquidity would result in significantly higher trading costs. Please find below two examples showing the additional charges for the energy industry: • Less liquid markets see bid/offer differentials widen as there are fewer available buyers and sellers and a less efficient distribution of the relevant supply and demand information. The table below shows the additional costs of trading in case of a widening bid/ask spread. Taking into account rough figures of European energy trading, the drifting apart of spreads could lead to an additional cost of **€4 bn**.

Bid Offer Cost									
Commodity	Country	Volume Units	Total Market Volume p.a.	Hedge Volume / Physical Consumption p.a.	Churn Ratio (Current)	Churn Ratio (Reduced Liquidity)	Current Bid Offer	Bid Offer (Reduced Liquidity)	Bid Offer Cost (Euros)
Power	UK	MWh	900,000,000	360,000,000	2.5	1.0	0.20	0.50	€ 145,800,000
Power	Germany	MWh	5,300,000,000	500,000,000	10.6	1.0	0.05	0.15	€ 50,000,000
Power	France	MWh	600,000,000	460,000,000	1.3	1.0	0.15	0.20	€ 21,000,000
Power	Netherlands	MWh	330,000,000	111,000,000	3.0	1.0	0.15	0.30	€ 16,650,000
Gas	Liquid	MWh	15,400,000,000	2,200,000,000	7.0	1.0	0.20	0.50	€ 660,000,000
Gas	Illiquid	MWh	10,500,000,000	2,300,000,000	4.6	1.0	0.50	1.00	€ 1,150,000,000
Coal	Europe	MT	2,000,000,000	700,000,000	2.9	1.0	1.00	2.86	€ 1,157,000,000
Oil	Europe	MT	8,130,000,000	880,000,000		*n/a*	0.25	1.25	€ 783,200,000
								Total	**€ 4,000,000,000**

- In a less liquid market, an asset-owner wishing to hedge its physical assets would need a longer period of time to close out its hedge volumes. The increase in the exposure over more days will lead to a market-wide increase in the Value at Risk of about €6bn (see table below). This value can then be translated as a cost of doing business in the industry by multiplying it by an average risk capital multiplier and a risk capital charge, hence amounting to approximately **€15bn per year.**

Close Out Risk												
Commodity	Country / Region	Volume Units	Total Market Volume p.a.	Hedge Volume / Physical Consumption p.a.	Churn Ratio (Current)	Churn Ratio (Reduced Liquidity)	Market Price	Volatility (Daily)	Confidence Interval	Days to Close Out Hedge Volume (Current)	Increase in Close Out Days	Close Out Risk
Power	UK	MWh	900,000,000	360,000,000	2.5	1	45.0	0.7%	1.65	50	125	£197,231,258
Power	Germany	MWh	5,300,000,000	500,000,000	10.6	1	32.0	0.8%	1.65	12	125	£458,411,588
Power	France	MWh	600,000,000	460,000,000	1.3	1	40.0	0.7%	1.65	96	125	£161,809,963
Power	Netherlands	MWh	330,000,000	111,000,000	3.0	1	40.0	0.8%	1.65	42	125	£67,369,159
Gas	Europe	MWh	26,000,000,000	4,500,000,000	5.8	1	23.0	1.1%	1.65	22	125	£3,010,274,760
Coal	Europe	MT	2,000,000,000	700,000,000	2.0	1	62.0	1.2%	1.65	44	88	£810,174,666
											Total	**€ 6,000,000,000**

(2) Cautious thresholds should be set at first to avoid small entities being forced to definitely exit the market and causing an irrevocable drop of liquidity. These threshlods could be eventually lowered based on in-depth economic analysis and lessons learnt from MiFID II application. This would be in line with the required MiFID review in 2018 for gas and power.

Q174	**Do you agree with ESMA's intention to use an accounting capital measure?**	Europex generally welcomes the approach of using an accounting capital measure for determining the "capital employed" as defined in Article 2(4). Yet, it is of great importance to provide companies with some flexibility and allow them to refer to proxies when using accounting capital to determine their "capital employed" both for the ancillary activity and the main business. Moreover, this measure needs to be a generally accepted standard with no (negative) impact on the application of the ancillary activity exemption. If any doubts occur, ESMA shall consider making a public consultation on this specific issue.
Q175	**Do you agree that the term capital should encompass equity, current debt and non-current debt? If you see a need for further clarification of the term capital, please provide concrete suggestions.**	Yes, Europex generally agrees with the approach.
Q176	**Do you agree with the proposal to use the gross notional value of contracts? Please provide reasons if you do not agree.**	Yes, Europex agrees.
Q177	**Do you agree that the calculation in relation to the size of the trading activity (numerator) should be done on the basis of the group rather than on the basis of the**	Yes, Europex agrees.

	person? (Please note that that altering the suggested approach may also have an impact on the threshold suggested further below)	
Q178	**Do you agree with the introduction of a separate asset class for commodities referred to in Section C 10 of Annex I and subsuming freight under this new asset class?**	Yes, Europex agrees.

Q179	**Do you agree with the threshold of 0.5% proposed by ESMA for all asset classes? If you do not agree please provide reasons and alternative proposals.**	• As far as gas and power trading is concerned, Europex considers the threshold to be significantly too low. Gas and power wholesale markets have only been liberalised recently. Due to their historical development, the market structure in these markets is less multipartite compared to other markets. Utility companies that used to be politically wanted regulated monopolies before the liberalisation would be easily caught by the 0.5% threshold.
		
		• As a consequence, such companies would either:
		  ○ reduce their trading activity and thus decrease liquidity of wholesale power and gas markets. This would throw these markets back by many years and undermine the achievements of the past 15 years,
		  ○ shift their trading activity to those segments that are not covered by the financial instrument definition, i.e. OTF platforms. This would circumvent the MiFID II and EMIR framework and would undermine the systemic risk mitigation efforts of the last years.
		
		• Defining specific thresholds for each asset class is therefore of great importance for an appropriate application of the ancillary activity exemption. This is especially true because of the rule that if one threshold is not met in one asset class, the MiFID II/MiFIR requirements will apply to all other asset classes as well.
		
		• **Use of TR data:** For gas and power trading, it is of utmost importance that the size of the overall trading activity in

		the relevant asset class takes into account the whole trading activity and not only the trading activity in financial instruments. For instance, as ESMA stipulates in paragraph 7.1. §48 of the Consultation Paper, contracts that are traded on OTFs and that must be physically settled will not be financial instruments but still represent a part of the trading activity in these sectors. Moreover, it should be noted that REMIT requires market participants to report non-financial instruments through ad-hoc databases (RRMs). This means the data from the whole trading activity will be available to regulators. For gas and power, data should hence not only come from MiFID Trade Repositories but also from REMIT recognised databases. Combining those figures will in any case be needed by ESMA and ACER to correctly supervise the energy markets. • If REMIT non-financial instruments were not taken into account for determining the size of the overall trading activity, it is likely that even small companies could be caught by the 0.5% threshold. Indeed, it is likely that some market participants will reduce their trading in financial instruments once MiFID II enters into full application. This would mean that small market participants would gain a bigger overall relative market share with all related consequences in relation to the statically set thresholds. • With many companies shifting their trading activity away from Regulated Markets to OTFs, the relative market share of firms remaining in the regulated market increases, in case only TR data is used to calculate the overall market trading activity. This may trigger a chain reaction of companies leaving the regulated market, the MiFID II and EMIR framework and of companies dropping out of the market. • Cautious thresholds should be set at first to avoid small entities being forced to definitely exit the market and causing an irrevocable drop of liquidity. These threshlods could be eventually lowered based on in-depth economic analysis and lessons learnt from MiFID II application. This would be in line with the required MiFID review in 2018 for gas and power.
Q180	**Do you think that the introduction of a de minimis threshold on the basis of a limited scope as described**	Europex fully supports the introduction of a de minimis threshold for small firms. However, this must not lead to a general in-or-out-decision with an overly diminished ancillary activity exemption for bigger companies.

	above is useful?	
Q181	**Do you agree with the conclusions drawn by ESMA in relation to the privileged transactions?**	Europex agrees with the ESMA conclusions. This applies in particular to point 70 of the Consultation Paper on the hedging exemption and the need to complement the reference by ETDs. Moreover, we fully support the reasoning of point 71 allowing for the full exemption of liquidity provision activities (e.g. market making) in commodity and emission allowances trading where required by EU or national law or by trading venues. In this context, the EU should consider generally introducing such an obligation for all member states. Europex believes that the provision of liquidity from market participants when engaging in algorithmic trading and pursuing market making strategies should also be considered as privileged transactions and hence should be deducted from the numerator.
Q182	**Do you agree with ESMA's conclusions in relation to the period for the calculation of the thresholds? Do you agree with the calculation approach in the initial period suggested by ESMA? If you do not agree, please provide reasons and alternative proposals.**	Europex agrees with determining the qualification for the exemption on the basis of a rolling average of three years. Against this background, it is very important to take into account that trading behaviour can fluctuate from one year to the other. However, Europex absolutely disagrees with the proposed interim approach. ESMA suggests that the trading data of 2016 is used to determine whether a firm can benefit from the ancillary service exemption in January 2017. This creates a number of problems: • Until today, it has not been fully defined yet what a financial instrument in the sense of MiFID I is and what a financial instrument in the sense of MiFID II will be. It seems thus very unlikely that there will be a harmonised and clear definition of financial instruments at the beginning of 2016, which would be a precondition for applying the methodology as suggested by ESMA. This is particularly true for derivatives that are classified as financial instruments in Annex I C (6) and C (7). • Regarding gas and power, MiFID II foresees a special exemption for contracts traded on an OTF that must be physically settled. However, firms can benefit from this exemption only as of 2017. Europex believes that the general exemption for gas and power trading may not be repealed before the C6 exemption fully enters into application. • The reporting obligation will not be in place either before 2017, which will make the collection of data particularly difficult in 2016. It will hence be nearly impossible to assess the trading activity threshold in 2016. • Europex believes that firms should be given the choice to (a) reduce their trading activity and to avoid becoming an investment firm or (b) not to reduce their trading activity and to apply for a license. Given the uncertainties outlined

		above, it will be almost impossible for a firm to anticipate the thresholds and to adjust its trading activity accordingly. This is particularly true with regard to the trading activity test, because firms cannot anticipate the behaviour of other firms trading in the same asset class(es). The suggested interim approach fully surprises Europex. To us, this is the main point of concern in the present consultation paper. We strongly recommend excluding the trading data from the year 2016 with respect to the ancillary activity exemption. The first 'ancillary activity test' should take place no sooner than at the beginning of 2018, when reliable data will be available. Additionally, Europex would like to emphasise that requiring firms to report to their national competent authorities on 3 January of year X their use of exemptions seems operationally very problematic, if not impossible. Indeed, the calculation of the ancillary activity requires access to figures that are not yet available at this point in time (i.e. the consolidated accounts of the group for year X or the global trading activity of year X). As an example, the approval of consolidated accounts of year X does generally not happen before April of year X+1.
Q183	**Do you have any comments on the proposed framework of the methodology for calculating position limits?**	Europex generally supports the framework proposed by ESMA. We agree that the deliverable supply is the most appropriate basis for the EU position limits regime, both for the spot month and for other maturities. This is because undue influence and control over deliverable supply, coupled with holding a significant futures position, can trigger a disorderly market. In contrast, we deem open interest inappropriate for the EU position limit regime for the following reasons: • As a matter of principle, holding a significant proportion of open interest in future contracts in isolation does not create a disorderly market. • Open interest can be very volatile. Depending on the time, trading volumes can differ significantly from one period to another and open interest as well. Therefore, position limits based on open interest would have to be adjusted very often. Deliverable supply is more stable, allowing for a more stable position limit regime. • Especially in gas and power markets, due to the C6 REMIT carve-out, financial instruments may only represent the minority of trading volumes compared to the overall market. As a result, open interest in financial instruments only represents a limited part of the whole market. Against this backdrop, a large relative position in open interests in financial instruments can be a small position when compared to the whole market. • The MiFID II application to gas and power derivatives may lead to a general decrease of liquidity in financial gas and power markets. There are two reasons for this: 1/ If the ancillary activity exemption is very restrictive, some

companies could significantly reduce their trading activity in financial instruments in order to avoid being MiFID regulated firms. 2/ this is particularly true as the REMIT carve-out may cause a shift of liquidity from the financial sector to the non-financial one (trading in physically settled instruments on OTFs).

Need for a clear, sector-specific and coherent European definition of deliverable supply

There has been no clear definition of deliverable supply in the context of MiFID so far. It is therefore of utmost importance that the deliverable supply is defined depending on the specificities of the different asset classes (or asset sub-classes).

Europex suggests determining the deliverable supply for gas and power markets inter alia based on European demand. This is key as markets are typically strongly interlinked. For gas, e.g., the UK hub NBP and the Dutch hub TTF are far more liquid than the other hubs and are used to cover activities in other countries too. The same is true for the German/Austrian bidding zone in power.

The deliverable supply should be adjusted every two years.

Need for exchange involvement in the determination of deliverable supply

Europex agrees that trading venues are well placed to source and provide data in relation to the determination of deliverable supply to the relevant National Competent Authorities. This is because trading venues:

- have ready access to such data;
- are independent of the trading interests of the participants which are active in the market; and
- have the legal obligation to operate orderly markets and in particular to apply associated position management controls in relation to the commodity derivatives concerned.

The deliverable supply data can be used by the National Competent Authorities in order to calculate the baseline levels for determining the position limits for the commodity contracts in question.

Q184	**Would a baseline of 25% of deliverable supply be suitable for all commodity derivatives to meet position limit objectives? For which commodity derivatives would 25% not be suitable and why? What baseline would be suitable and why?**	Europex deems a 25% baseline level a suitable starting point for calculating position limits applicable to commodity derivatives in the EU. After establishing the baseline for each commodity derivative, it will indeed be necessary to consider the extent to which the seven factors enumerated in MiFID II should increase or decrease this level in order to set the spot month and other months position limits for each commodity derivative. Yet, it remains difficult to assess these figures exactly as no further information on how deliverable supply will be calculated is available for the time being. In this context, it is important that the deliverable supply is defined and determined properly in order to ensure a correct application of the thresholds.
Q185	**Would a maximum of 40% position limit be suitable for all commodity derivatives to meet position limit objectives. For which commodity derivatives would 40% not be suitable and why? What maximum position limit would be suitable and why?**	Europex believes that 40% of deliverable supply should be an indicative boundary rather than a hard cap. This is because particular circumstances may occur in which greater flexibility is appropriate. For instance, a figure of 40% may be too restrictive for certain nascent or niche products (cf. our responses to Questions 189 and 195). Yet, it remains difficult to assess these figures exactly as no further information on how deliverable supply will be calculated is available for the time being.
Q186	**Are +/- 15% parameters for altering the baseline position limit suitable for all commodity derivatives? For which commodity derivatives would such parameters not be suitable and why? What parameters would be suitable and why?**	+/- 15% seems to be a reasonable number provided that it remains an indicative boundary rather than a hard cap / floor. As the methodologies for setting position limits and deliverable supply are not totally clear yet, it is difficult to assess more precisely the impact of such +/- 15% parameters. Europex believes that some of the factors which ESMA may use to alter the baseline level should be given greater weight than others, given their greater relevance to orderly markets and pricing considerations (Cf. our response to Question 187 for further details).

Q187	**Are +/- 15% parameters suitable for all the factors being considered? For which factors should such parameters be changed, what to, and why?**	Europex is convinced that the listed factors in question should not be equally weighted. Europex favours the option to take deliverable supply as a baseline from which to apply position limits. For parameters altering the baseline position, most weight should be given to the size of deliverable supply, the maturity of the contracts and the state of development of the market. These three are the key factors for the design of position limits which support orderly pricing and settlement conditions and prevent market abuse. A second category of factors should be given a medium weighting (i.e. number and size of participants, characteristics of the underlying market and new contracts), as they are also relevant for calibrating the application of position limits in the market in question. A third category should be given a low weighting (i.e. open interest and volatility) for the following reasons: • Open interest should not be viewed in isolation. It is unavoidably backward-looking and presupposes a certain number of participants in the market in order to work. For instance, a per-participant limit of 5% of the open interest would require at least 20 participants with 5% of open interest each. This cannot be assumed to always be the case. Indeed, in the interests of the efficacy of nascent or niche markets – in which there may be only a handful of active market participants – it might be necessary to introduce a threshold level below which the application of position limits would be suspended. • Another factor is "volatility". This term is often confusingly (mis-)used for describing pricing distortions that can occur (whether for technical or nefarious reasons) in commodity markets as a contract approaches maturity. Rather than volatility per se (which implies that the price of the spot month is rising and falling sharply during a short period of time), it is more likely that any pricing distortions would be characterised by increases or decreases in price in a clear direction and/or a change in the pricing relationship between the spot month and the next delivery month.
Q188	**Do you consider the methodology for setting the spot month position limit should differ in any way from the methodology for setting the other months position limit? If so, in what way?**	As ESMA has proposed in its CP, the baseline level for both the spot month position limit and the other months position limit should be based on deliverable supply. This is because of undue influence and control over deliverable supply, coupled with holding a significant futures position, which can result in a disorderly market. The only distinctions which the methodology needs to allow for – and already does so - between the spot month position limit and the other months position limit is to recognise the facts that: • the other months position limit is likely to cover many production periods, rather than just one, and thus will be based on a wider measure of deliverable supply than the spot month position limit; and • the other months position limit is a single limit covering multiple delivery months, rather than just one.

		As a result, position limits will be broader in relation to delivery months which are far from maturity (i.e. the "other months") and will become narrower and more restrictive as maturity approaches (i.e. once the delivery month in question becomes the spot month). This will reflect the availability of deliverable supply during two distinct phases in the life cycle of the delivery month. By doing so, the level of position limits during those different phases will reflect the extent to which the price of the delivery month is susceptible to distortion or manipulation.
Q189	**How do you suggest establishing a methodology that balances providing greater flexibility for new and illiquid contracts whilst still providing a level of constraint in a clear and quantifiable way? What limit would you consider as appropriate per product class? Could the assessment of whether a contract is illiquid, triggering a potential wider limit, be based on the technical standard ESMA is proposing for non-equity transparency?**	Special care needs to be taken in applying the position limits regime to nascent or niche markets, in which there may be only a handful of active market participants either at the outset or on an ongoing basis. It might be necessary to apply a threshold test – possibly expressed as a number of active market participants - below which the application of position limits would be suspended until such time as participation increases. If such a measure is not introduced, it is possible that many nascent and niche markets will not be able to co-exist with the position limits regime.
Q190	**What wider factors should competent authorities consider for specific commodity markets for adjusting the level of deliverable supply calculated by trading venues?**	In relation to the "other months", the key factor is the number of production periods between the point in time at which the position limit is set and the maturity date of the relevant contracts. In most cases, the trading venue should have considered this in calculating a deliverable supply measure for the "other months". In relation to the spot month, the key factor will vary depending on the product concerned (again, the trading venue should have already taken this into account in calculating a deliverable supply measure for the spot month). .

Q191	**What are the specific features of certain commodity derivatives which might impact on deliverable supply?**	The trading venue and National Competent Authority will need to consider the likely impact of any exogenous events or longer-term trends, which could affect future deliverable supply positively or negatively.
Q192	**How should 'less-liquid' be considered and defined in the context of position limits and meeting the position limit objectives?**	Special care needs to be taken in applying the position limits regime to less liquid markets, in which there may be only a handful of active market participants either at the outset or on an ongoing basis. Less stringent position limits should apply, if any.
Q193	**What participation features in specific commodity markets around the organisation, structure, or behaviour should competent authorities take into account?**	Special care needs to be taken in applying the position limits regime to nascent or niche markets, in which there may be only a handful of active market participants either at the outset or on an ongoing basis. It might be necessary to apply a threshold test – for instance, expressed as a number of active market participants - below which the application of position limits would be suspended until such time as participation increases. If such a measure is not introduced, it is possible that many nascent and niche markets will not be able to co-exist with the position limits regime.
Q194	**How could the calculation methodology enable competent authorities to more accurately take into account specific factors or**	ESMA has correctly identified the main features of the underlying commodity markets which would need to be taken into account by National Competent Authorities in establishing position limits.

	characteristics of commodity derivatives, their underlying markets and commodities?	
Q195	**For what time period can a contract be considered as "new" and therefore benefit from higher position limits?**	It is not possible to quantify a meaningful time period applicable to all contracts because: • contracts mature at different rates; • once they are mature, some contracts will become benchmark products whilst others will remain niche products with limited participation. Furthermore, Europex believes that applying an arbitrary cut-off point beyond which a contract is no longer regarded as "new" – at which point lower position limits would automatically apply - may have the effect of stifling the development of nascent products and damaging the viability of niche products. Instead of applying an arbitrary quantitative cut-off point, National Competent Authorities should consider qualitative factors (such as those mentioned in the previous paragraph) when determining whether a contract should continue to be regarded as "new". Cf. our response to Question 193, which is directly related to this issue.
Q196	**Should the application of less-liquid parameters be based on the age of the commodity derivative or the ongoing liquidity of that contract.**	Cf. our response to Question 195.
Q197	**Do you have any further comments regarding the above proposals on how the factors will be taken into account for the position limit calculation methodology?**	No.

Q198	**Do you agree with ESMA's proposal to not include asset-class specific elements in the methodology?**	Yes. Europex agrees that the factors enumerated under Article 57(3)(a)-(g) of MiFID II, and the manner in which ESMA proposes to frame the methodology, provides National Competent Authorities with sufficient scope to take into account the specificities of different markets without incorporating asset-class specific elements into the methodology. There has been no clear definition of deliverable supply in the context of MiFID so far. It is of great importance that the deliverable supply is defined depending on the specificities of the different asset classes (or asset sub-classes).
Q199	**How are the seven factors (listed under Article 57(3)(a) to (g) and discussed above) currently taken into account in the setting and management of existing position limits?**	The main factors to be taken into account for the design and application of existing limits and controls by EU trading venues (e.g. delivery limits and accountability levels) are deliverable supply, the remaining time to contract maturity and – during the delivery period itself – the size of deliverable position without causing logistical problems or a delivery failure.
Q200	**Do you agree with the proposed draft RTS regarding risk reducing positions?**	Europex agrees with ESMA's proposed approach of defining "risk reducing positions" in a manner which is consistent with the relevant definition under EMIR ((Regulation (EU) 638/2012), Article 10(4)(a), and the Commission Delegated Regulation (EU) No. 149/2013, Article 10). The purpose of EMIR Article 10(4)(a) is to identify a non-financial counterparty's positions which are "objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity of the non-financial counterparty". Such positions are not taken into account for the calculation of a non-financial counterparty's overall position in OTC derivatives in relation to the EMIR clearing threshold. This is analogous to the process under MiFID II whereby position limits in respect to commodity derivatives shall not be included in the calculation of the positions of a non-financial entity which are "objectively measurable as reducing risks related to that entity's commercial activity". Both the MiFID and EMIR RTS on risk reducing positions should be fully consistent with each other.

Q201	**Do you have any comments regarding ESMA's proposal regarding what is a non-financial entity?**	In its 2014 MiFID II Discussion Paper, ESMA noted that the expression "non-financial entity" is not defined in MiFID II and proposed to consider "non-financial entities" to be any entities which are not financial institutions under MiFID II or other relevant EU legislation. Such an approach may not work effectively in the context of the MiFID II position limits regime, given that many participants in EU commodity markets are located outside the EU. A strict application of such an approach would for instance suggest that an investment firm or a bank located in a third country would be treated as a "non-financial entity" rather than a financial entity.
Q202	**Do you agree with the proposed draft RTS regarding the aggregation of a person's positions?**	Cf. our response to Question 203.
Q203	**Do you agree with ESMA's proposal that a person's position in a commodity derivative should be aggregated on a 'whole' position basis with those that are under the beneficial ownership of the position holder? If not, please provide reasons.**	Europex believes that the methodology for aggregating positions - in a situation in which one company has an ownership interest in another - should be based on a discrete percentage threshold which is used as a proxy of "control". It suggests that the threshold should be set at 50%. Where the threshold is met, the totality of the position of the controlled entity should be added to the position of the controlling entity for the purposes of calculating the overall net position.
Q204	**Do you agree with the proposed draft RTS regarding the criteria for determining whether a contract is an economically equivalent OTC contract?**	Yes. ESMA's proposed approach is similar to the CFTC's proposal in relation to economic equivalence of swaps and futures contracts, which is designed to identify an entity's overall influence on the demand and supply conditions in a particular commodity sector, whilst recognising that the component contracts of that entity's position are not necessarily legally identical. Given the global nature of many commodity markets, there would be clear benefits in the EU and US applying consistent definitions of "economically equivalent" for the purposes of operating their position limits regimes.

Q205	**Do you agree with the proposed draft RTS regarding the definition of same derivative contract?**	Special care needs to be taken when using the term "same derivative contract". The purpose of the term (as used in Article 57(12)(d) of MiFID II) is to manage a situation where a single position limit needs to be set in relation to the trading of commodity derivatives at competing trading venues. In the given context, Europex has no further comments on the proposed approach.
Q206	**Do you agree with the proposed draft RTS regarding the definition of significant volume for the purpose of article 57(6)?**	Yes, Europex agrees.
Q207	**Do you agree with the proposed draft RTS regarding the aggregation and netting of OTC and on-venue commodity derivatives?**	Cf. our response to Question 204.
Q208	**Do you agree with the proposed draft RTS regarding the procedure for the application for exemption from**	The proposed draft Regulatory Technical Standard (Article 7 of RTS 30) stipulates that a National Competent Authority (NCA) will be given up to 30 calendar days to approve an application for an exemption. This is a significantly long period, during which the non-financial entity will face regulatory uncertainty about whether or not an exemption will be available to it. We therefore suggest reducing this period.

	the Article 57 position limits regime?	
Q209	**Do you agree with the proposed draft RTS regarding the aggregation and netting of OTC and on-venue commodity derivatives?**	Cf. our response to Question 204.
Q210	**Do you agree with the reporting format for CoT reports?**	Europex generally agrees with ESMA’s proposal for the reporting format. However, the position reporting regime should ensure a high level of confidentiality by not disclosing details of position holders to the extent that they may be identifiable. Reporting of all fields with a distinction between ‘risk reducing’ and ‘other’ may put this confidentiality at risk, if there is only one holder in any of these two groups. Example: Total number of position holders in one category exceeds four and therefore it should be disclosed. However, there is only one position holder out of four whose positions can be qualified as reducing risk. As a result, with reference to that position holder the number of long and short open positions would be made public. The same situation occurs if there is only one position holder out of four whose positions can be qualified as ‘other’. Therefore, the field ‘number of position holders’ in a given category should not differentiate between ‘risk reducing’ and ‘other’.
Q212	**What other reporting arrangements should ESMA consider specifying to facilitate position reporting arrangements?**	ESMA should take into account that market operators are not in possession of data on open positions of their members. Such information will have to be obtained from the respective Central Counterparties (CCPs). Therefore, market operators can only partly bear responsibility for the adequacy of the information.