European Securities and Markets Authority

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Additional Information

Level 1 Regulation
Markets in Financial Instruments Directive II (MiFID II) Directive 2014/65/EU- Secondary Markets

Topic
Position limits

Subject Matter
Intercommodity spread or diff contracts

Question
How are position limits applied to intercommodity ‘spread’ or ‘diff’ contracts?

ESMA Answer

23-09-2022

Original language

[ESMA70-87294901 Commodity derivatives, Position limits Q&A 17]

A commodity derivative contract in the legal form of a “spread” or “diff” contract is a cash-settled contract whose value is determined by the difference between two reference commodities that may vary in, inter alia, type, grade, location, or delivery characteristics. Whilst having multiple underlying constituents, the spread derivative is available on a trading venue as a single tradable financial instrument.

A spread contract differs from a ‘spread trading strategy’ (two or more commodity contracts traded together to achieve a particular economic effect), as such a strategy may be executed by a single action in a venue’s trading systems, but it remains composed of separate, and legally distinct commodity derivatives which are executed as trades simultaneously.

As a spread contract has no single underlying commodity at a specific place or time, it is not possible to link it to a single physical deliverable supply against a contractual obligation to physically settle the trade. It is for this reason all spread contracts are cash-settled and not physically settled.

Article 57(4) of MiFID II states ‘A competent authority shall set limits for critical or significant commodity derivatives and agricultural commodity derivatives that are traded on trading venues based on the calculation methodology laid down in regulatory technical standards adopted by the Commission […]’. Whilst specifically referencing each contract, this should refer to outright instruments (i.e. the disaggregated components of spreads) and the limits be applied at that level. The prevailing limits will apply to the net eligible positions, which include the positions held in the disaggregated component of a spread contract as set out in Article 3(2) of RTS 21a.

In cases where a constituent leg is not independently admitted for trading, then the spread itself will receive a limit (de minimis or bespoke). In these cases, the same methodology as for C10 commodity derivatives that have no physical underlying will apply, as such the open interest figure for the spread shall be used as the baseline for both the Spot Month and Other Months’ limits.