

## OPINION on position limits on ICE Singapore Jet Kerosene contracts

### I. Introduction and legal basis

1. On 20 September 2017, the European Securities and Markets Authority (ESMA) received a notification from the Financial Conduct Authority (FCA) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments<sup>1</sup> (“MiFID II”) regarding the exact position limits FCA intends to set for ICE Singapore Jet Kerosene Futures and Options commodity contracts in accordance with the methodology for calculation established in Commission Delegated Regulation (EU) 2017/591 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the application of position limits in commodity derivatives<sup>2</sup> (“RTS 21”) and taking into account the factors referred to in Article 57(3) of MiFID II.
2. ESMA’s competence to deliver an opinion is based on Article 57(5) of MiFID II. In accordance with Article 44(1) of Regulation (EU) 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority)<sup>3</sup> (“ESMA Regulation”), the Board of Supervisors has adopted this opinion.

### II. Contract classification

Commodity base product: energy (NRGY)

Commodity sub product: oil (OILP)

Commodity further sub product: jet fuel (JTFL)

Name of trading venue(s): INTERCONTINENTAL EXCHANGE - ICE FUTURES EUROPE

MIC: IFEU

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<sup>1</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349).

<sup>2</sup> Commission Delegated Regulation (EU) 2017/591 of 1 December 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the application of position limits commodity derivatives (OJ L 87, 31.3.2017, p. 479).

<sup>3</sup> Regulation (EU) 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15. 12.2010, p. 84).



Venue product code: SRS<sup>4</sup>

### III. Market description

3. Jet fuel (also known as kerosene) is an internationally-traded and relatively homogenised refined product and is readily arbitrated for a competitive aviation fuel market, composing of ten 25% or more of airline costs.
4. Jet Kerosene is assessed by the price reporting agency, Platts. Their methodology defines the Singapore Jet Kerosene as "standard commercial Jet-A1 specifications, as defined by UK Ministry of Defence in DEFSTAN 91-91, unless otherwise stated". Its "specific gravity is typically 0.8 g/m. Singapore smoke point is typically 19-21, and premiums may be paid for higher smoke point and discounts for lower smoke point. Colour specification for FOB Straits cargoes reflects a minimum of 18 Saybolt colour guarantee".
5. Platts is the underlying index provider for price assessment on this contract. Their assessment is based on numerous bids, offers and trades "of a minimum of 100,000 barrels, maximum 250,000 barrels, loading 15-30 days from date of publication".<sup>5</sup>
6. This specific contract is available on ICE Futures Europe and on CME Globex as 'Singapore Jet Kerosene (Platts)' as a cash-settled contract. Based on the characteristics of the contract, market participants are likely to be mainly commercial.
7. The underlying physical market may be affected by the usual factors for commodities including geopolitical and industry issues, weather variables and economic fluctuations. No factors that would justify an adjustment from the baseline have been identified.
8. The restrictions on supply are not considered as a relevant factor given that the contract is financially settled. There is no specification for physical delivery under this contract.
9. ICE also offers trading in the Singapore Jet Kerosene Average Price Options. On expiry day, options automatically exercise into the futures contract at the exercise price, i.e. at the "strike price" if the option is "in the money".
10. ICE further offers trading in ICE Singapore Jet Kerosene Balmo and Mini futures. A Balmo ("balance of the month contract") is a future contract taken out on any day of the spot month and is settled on the last trading day of that month. The Balmo shares contract specifications with the whole month contract (the principal) and is priced off the same underlying. A Mini contract is traded on the same trading venue as the principal contract, but in a smaller lot size. The Mini and the principal contracts share all other specifications and are priced off the same underlying commodity.

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<sup>4</sup> This is the primary venue product code (VPC) for this contract. However, the position limits set will apply to other associated VPCs as well. For a complete and updated list of VPCs to which the same limit applies, please check the FCA website at <https://www.fca.org.uk/markets/mifid-ii/commodity-derivatives/position-limits>.

<sup>5</sup> Source: Platts Methodology and Specifications Guide, Europe and Africa Refined Oil Products



11. In respect of daily settlement, the price is determined by ICE using price data from a number of sources including spot, forward and derivative markets for both physical and financial products. For final settlement, the price is a price in USD and cents per barrel based on the average of the mean of the high and low quotations appearing in the "Platts Asia Pacific/Arab Gulf Marketscan" under the heading "Asia Products" subheading "Singapore" and "FOB Singapore" for "Kerosene" for each business day in the determination period.
12. Estimated number of market participants / market makers: 105 / 0

#### **IV. Proposed limit and rationale**

##### Deliverable supply

13. Deliverable supply amounts to 153,126 lots. A lot is equivalent to 1,000 barrels.
14. The ICE Futures Europe Singapore Jet Kerosene Future is cash settled against a price assessment in Platts Asia-Pacific/Arab Gulf Marketscan. Platts considers market activity from a range of ports in Singapore and Malaysia in their assessment, termed "FOB Straits" to reflect the regional delivery location.
15. Deliverable supply has been calculated by using production and import data in Malaysia and Singapore, as well as storage tank capacity at the recognised 'Straits Terminals' as defined by Platts in their methodology guide. Data on actual stocks in tanks are not available to the FCA and tank capacity has therefore been used as the best available proxy. The data source for production and imports is the UN Statistics Division; while the storage tank capacity has been calculated by adding together the capacity of the tanks able to hold jet kerosene. The storage tank capacity list was last updated by Platts in May 2017.
16. According to the UN Statistics Division, Energy Statistics Database 1990-2014, which is the latest available version, the average annual production and imports for Malaysian and Singapore kerosene-type Jet Fuel for 2012-2014 is 15,021,000 metric tonnes per year or 110,103,930 barrels (by multiplying mt by 7.33) per year. Dividing this figure by 12 provides 9,175,327 barrels per month. The Storage Terminal Capacity as at May 2017 from Platts' most recent update is 22,889,214 cubic metres. This is equivalent to 143,950,267 barrels (by multiplying cubic metres by 6.289). Adding this storage capacity figure to the monthly production and import figure amounts to 153,125,594 barrels. Divided by 1,000 equates to 153,126 lots.<sup>6</sup>

##### Spot month position limit

17. Spot month limit amounts to 38,250 lots. A lot is equivalent to 1,000 barrels.

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<sup>6</sup> Source: UN Statistics Division & Platts Methodology and Specifications Guide (Asia Pacific and Middle East Refined Oil Products) May 2017



18. The position limit applies to the ICE Futures Europe Singapore Jet Kerosene Future and Option contract and to other Mini/Balmo contracts which are based on identical core (underlying) contractual specifications, terms and conditions. The FCA's website provides an updated list showing the names and codes for these contracts.
19. The FCA is of the view that if separate limits are applied to Balmo, Mini and other types of closely related contracts, the overall position of a participant on the same underlying may not be clearly represented. The FCA also considers that setting a single position limit for aggregated Balmo, Mini, and principal contracts traded on the same venue where there are identical contract specifications, terms and conditions, is compliant with the objectives of the MiFID II regime and of RTS 21. It avoids the creation of multiple limits for identical commodities and the potential undermining of the overall intentions of the regime. In particular, it enhances the approach already established with the aggregation of positions under Article 57 of MiFID II and Articles 5 and 6 of the RTS 21 for same commodity derivatives and EEOCs, where positions are also aggregated with the primary on-venue contracts and become subject to one position limit. It also appears consistent with Article 3 of RTS 21, which provides for position holders to calculate their option positions on a delta adjusted basis by commodity derivative and then aggregate these with the principal commodity derivative contract.

#### Spot month position limit rationale

20. The baseline for the spot month has been set at 25% of deliverable supply as required by Article 9(1) of the RTS 21.
21. The contract is cash settled against Platts daily assessment price for Singapore Jet Kerosene. Therefore, factors in RTS 21 related to settlement through physical delivery are not considered relevant.
22. All other factors have been considered and are not regarded as material or relevant to require additional adjustments, either up or down from the baseline. In considering the volatility in the contract, as required by Article 21 of RTS 21, there has been some variation in the price of the commodity derivative but FCA has not found evidence that this is excessive or that lower position limits would reduce volatility.
23. For the spot limit, no adjustments were made to the baseline at 25%. This provides a figure in lots of 38,282 lots, which has been rounded down to a figure of 38,250 lots. This equates to a final limit as a percentage of deliverable supply of 25.0%

#### *Other months' position limit*

#### Open interest

24. Open interest amounts to 61,157 lots. A lot is equivalent to 1,000 barrels.

25. For the calculation of open interest, the FCA has aggregated open interest in Balmo, Mini and principal contracts traded on the same venue where there are identical contract specifications, terms and conditions and where those contracts are subject to the same position limits. The FCA considers that aggregating open interest in all these contracts provides a simpler, more consistent overview of market participant activity in accordance with the objectives of Article 57 of MiFID II and RTS 21.
26. The open interest figure has been calculated from data supplied by the trading venue.
27. Open interest in this contract was highly variable over 2016 with peak open interest 37% greater than the average. There are regular peaks of open interest as contract expiry approaches. Taking average open interest as the baseline for the position limit might prevent the market working adequately during peak periods.
28. Therefore for the core contract, the FCA has applied the open interest figure on the day representing the 95th percentile for the open contracts which have not been closed out or expired. The FCA has also included the annual average figure for delta-adjusted options on this contract. The period used is the calendar year 2016.

#### Other months' position limit

29. Other months limit amounts to 18,350 of lots. The position limit applies to the ICE Futures Europe Singapore Jet Kerosene Future contract and to other Mini, Balmo contracts which are based on identical core (underlying) contractual specifications, terms and conditions. The FCA's website provides an updated list showing the names and codes for these contracts. See also paragraph 19 above.

#### Other months' position limit rationale

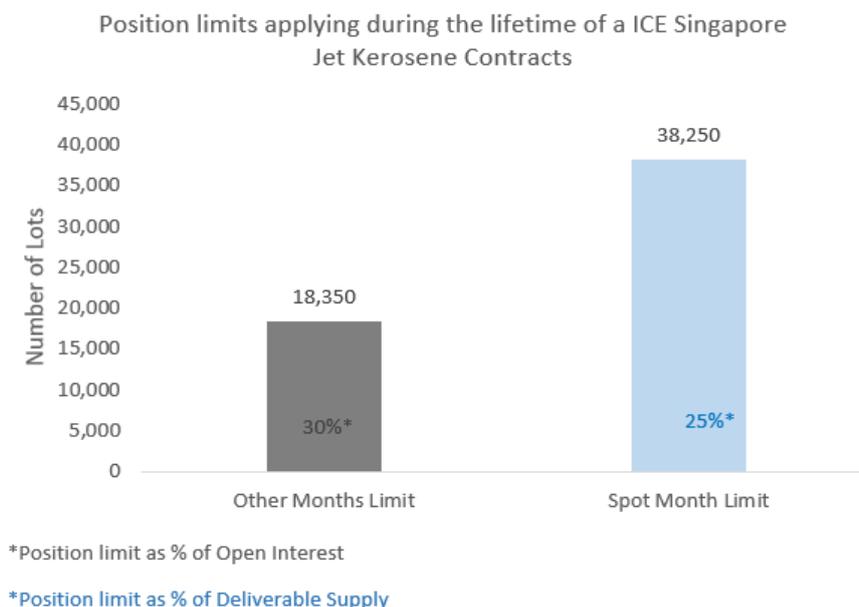
30. The baseline for the other months has been set at 25% of open interest as required by Article 11(1) of RTS 21.
31. An upwards adjustment of 5 percentage points was made for open interest being significantly lower than deliverable supply (40%) under Article 18(3) of RTS 21. The other characteristics of the contract were considered and no further adjustments were considered necessary.
32. For the other months, a total upwards adjustment of 5 percentage points was made resulting in an adjusted position limit of 30%. This provides a figure in lots of 18,347 lots which has been rounded up to a figure of 18,350 lots. This equates to a final limit as a percentage of open interest of 30%.

## V. ESMA's Assessment

33. This Opinion concerns positions held in ICE Singapore Jet Kerosene Future and Option contracts as well as in other Mini, Balmo contracts that are based on identical core (underlying) contractual specifications, terms and conditions, as shown on the FCA's website.
34. ESMA has performed the assessment based on the information provided by FCA.
35. For the purposes of this Opinion, ESMA has assessed the compatibility of the intended position limits with the objectives of Article 57(1) of MiFID II and with the methodology for calculation of position limits established in RTS 21, in accordance with Article 57(3) of MiFID II.

*Compatibility with the methodology for calculation of position limits established in RTS 21 in accordance with Article 57(3) of MiFID II*

36. The FCA has set one position limit for the spot month and one position limit for the other months.



### Spot month limit

37. The calculation of the deliverable supply is based on production, import and storage data provided by available public sources. The first two figures are obtained from the UN Statistics Division, where the average annual figure of 110,104 lots is divided by 12 to arrive to the monthly estimation of 9,175 lots. The storage figure of 143,950 lots is obtained from publication of Platts and is constituting the major part of the total deliverable supply, i.e. 94%. ESMA notes that the assumption made by the FCA for storage based on Platts figures is generous, since the storage facilities taken into account can be used not only by the Singapore Jet Ker-

osene but also for other fuels. However given the lack of available statistics regarding more detailed storage facility for this commodity, ESMA believes that this approach is sensible.

38. Therefore, ESMA considers that the way deliverable supply was calculated is consistent with Article 10(2) of RTS 21, which sets out that “Competent authorities shall determine the deliverable supply [...] by reference to the average monthly amount of the underlying commodity available for delivery over the one year period immediately preceding the determination”.
39. Compared to the baseline of 25% of deliverable supply for derivative contracts where the underlying commodity does not qualify as food intended for human consumption, the position limit has not been adjusted.
40. ESMA agrees that many of the adjustment factors set out in RTS 21 for the spot month are linked to the underlying commodity and the underlying commodity market and that those adjustment factors do not appear to be relevant for cash settled contracts such as the ICE Singapore Jet Kerosene Future.

#### Other months' limit

41. The open interest was calculated as the 95<sup>th</sup> percentile for the open contracts reported during the year 2016, which have not been closed out or expired.
42. ESMA considers such an approach consistent with Article 12 of RTS 21 and sensible in this case as such approach allows the market to work properly also during the regular peak periods. Using the average figure in this case could prevent the correct functioning of the market.
43. Compared to the baseline of 25% of open interest the other months' position limit has been adjusted upwards to take into consideration the fact that open interest is significantly lower than deliverable supply. This is consistent with Article 18(3) of RTS 21.
44. Consequently, these position limits have been set following the methodology established by RTS 21.

#### *Compatibility with the objectives of Article 57(1) of MiFID II*

45. ESMA has found no evidence indicating that the proposed position limits are not consistent with the objectives of preventing market abuse and supporting orderly pricing and settlement conditions established in Article 57(1) MiFID II.
46. ESMA considers that these position limits have been set in accordance with the above-mentioned objectives and are suitable for the conditions under which they will be active. ESMA notes that the ICE Singapore Jet Kerosene Future contract is cash settled. As the settlement price of the contract is based on the average reference price published by a price reporting agency, it is critical that the reference price is based on a sound and transparent



methodology that complies with all international standards for price reporting agencies set forth by the International Organization of Securities Commissions (IOSCO) for spot market pricing.

47. Overall, the position limits set for the spot month and for the other months appear to achieve a reasonable balance between the need to prevent market abuse and to ensure an orderly market and orderly settlement while ensuring that the development of commercial activities in the underlying market and the liquidity of the Singapore Jet Kerosene Future contracts are not hampered.

## **VI. Conclusion**

48. Based on all the considerations and analysis presented above, it is ESMA's opinion that this spot month position limit does comply with the methodology established in RTS 21 and is consistent with the objectives of Article 57 of MiFID II. The other months' position limit does comply with the methodology established in RTS 21 and is consistent with the objectives of Article 57 of MiFID II.

Done at Paris, 3 April 2018

Steven Maijoor

Chair

For the Board of Supervisors