Date: 24 October 2017
ESMA70-155-2274

OPINION on position limits on Robusta Coffee contracts

I. Introduction and legal basis

1. On 7 August 2017, the European Securities and Markets Authority ("ESMA") received a notification from the Financial Conduct Authority under Article 57(5) of Directive 2014/65/EU on markets in financial instruments[1] ("MiFID II") regarding the exact position limits the FCA intends to set for the Robusta Coffee Futures and Options commodity contract 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[2] ("RTS 21") and taking into account the factors referred to in Article 57(3) of MiFID II. This notification was supplemented by additional data provided on 6 October 2017.

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)[3] ("ESMA Regulation"), the Board of Supervisors has adopted this opinion.

II. Contract classification

Commodity base product: agricultural (AGRI)

Commodity sub product: softs (SOFT)

Commodity further sub product: robusta coffee (ROBU)

Name of trading venue: ICE FUTURES EUROPE – AGRICULTURAL PRODUCTS DIVISION

MIC: IFLX

Venue product code: RC

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[1] 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).
[2] 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).
[3] 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).

III. Market description

3. Brazil, Vietnam, Colombia and Indonesia are the main coffee producing countries. Europe is the largest consumer of coffee followed by the U.S., Asia and South America.[4]

4. Coffee plants do not reach maturity for three to five years so there is a lag between price signals being sent by the coffee market and increases or decreases in the level of physical production. Coffee is a seasonal crop although the possibility of trading throughout the year and receiving delivery from stored stocks means that it is not entirely dependent on seasonal yields to determine the price.

5. Robusta coffee prices have decreased from an average of $2.22 per kilo in 2014 to $1.95 in 2016. The increased price of $2.29 for April 2017 stems from a market deficit in 2016-2017 due to poor crops in Brazil, Indonesia, and Vietnam which resulted in an 11% output decline in 2016.[5]

6. The underlying commodity of the ICE Robusta Coffee Futures contract qualifies as food for human consumption.

7. Trading in the ICE Robusta Coffee Futures contracts takes place in lots. One lot is equivalent to 10 metric tonnes. Delivery months are January, March, May, July, September and November. Ten delivery months are available for trading. At expiry, the ICE Robusta Coffee Futures contract is physically settled.

8. ICE Robusta Coffee Options expire the third Wednesday of the calendar month preceding the expiry month. The exercise of options results in the assignment of future contracts at the exercise price, i.e. at the strike price.

9. Class 1 Robusta Coffee will be deliverable at the contract price although other grades are deliverable against the contract with adjustments at set premiums and discounts. Consequently, the supply is not restricted only to the highest grade of coffee. Robusta Coffee may be delivered from any origin that is freely available for export to any destination.

10. ICE Europe has a network of nominated warehouses for bagged storage. The bagged storage warehouses serve a network of twelve delivery areas and ports in Europe and the US. Coffee is easily transportable as it is typically delivered in 60kg bags. The commodity is delivered into an Exchange Nominated Warehouse in a delivery area that is in or sufficiently close to the locations of Amsterdam, Antwerp, Bremen, Felixstowe, Hamburg, Humberside, Le Havre, Liverpool, London, New Orleans, Rotterdam or Teesside. The FCA is not aware of any constraints on the receipt or delivery of coffee that would justify an adjustment to the position limit.

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4 Source: World Bank Commodity Markets Outlook, January 2017 & International Coffee Organisation, Consumption
5 Source:World Bank, Commodity Markets Outlook, January 2017 & International Coffee Organisation, What's New

11. Coffee is not an immediately perishable item but will deteriorate if stored for significant periods of time.

12. Robusta coffee for physical settlement is not traded on any other exchanges in addition to ICE Futures Europe. There is a cash-settled coffee index contract traded on Kansai Commodities Exchange (KEX) (Japan) but this does not affect the physical deliverable supply.

13. The ICE Robusta Coffee Futures contract is actively traded by producers, exporters, trade houses, importers and roasters as well as by managed funds and financial investors. There are 146 market participants and one market maker.

14. The Robusta Coffee futures contract is used as the global benchmark for the pricing of physical Robusta Coffee.

IV. Proposed limit and rationale

Spot month position limit

<u>Deliverable supply</u>

15. Deliverable supply amounts to 98,669 lots. A lot is equivalent to 10 metric tonnes.

16. The FCA has used the following methodology to calculate deliverable supply.

17. Deliverable supply of Robusta coffee is estimated based on trade venue data and independent figures from the International Coffee Organisation (ICO), US Department of Agriculture (USDA) and the World Bank. Although the World Bank provides a general overall figure which does not distinguish Robusta and Arabica production, the figures are generally in line with the USDA and ICO, albeit slightly higher. For 2014-2016, average annual global production of coffee was around 9.2 million tonnes. Global production of Robusta was around 3.3 million tonnes in 2016.[6]

18. Dividing total annual production by the number of delivery months under the contract over the twelve month production period (in this case six separate expiries) provides a deliverable supply figure, from production only, of 550,000 metric tonnes (MT) per expiry or 55,000 lots.

19. For any individual delivery month for coffee it is possible, however, to deliver coffee which is currently in storage as well as to transport and prepare for delivery fresh production from origin countries. Stock levels therefore need to be added to production figures to estimate total deliverable supply.

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6 Source: World Bank, Commodity Market Outlook, January 2017 & International Coffee Organisation, Total Production By All Exporting Companies

20. Average stock data for 2016 has been obtained from the European Coffee Federation (270,385 MT) and the Green Coffee Association (166,301 MT) as a representation of global stock levels. Based on these inputs, the stock level figure included in the FCA calculation of deliverable supply is 436,686 MT or 43,669 lots. Added to the production figure of 55,000 lots, this gives a total deliverable supply figure of 98,669 lots.

Spot month position limit

21. The spot month limit is set at 19,700 lots, i.e. 20% of deliverable supply. The spot month definition includes 60 calendar days. The spot month limit applies to ICE Robusta Coffee Futures and Options contracts.

22. In addition to the spot month limit set by the FCA, ICE has delivery limits that apply in the period immediately prior to the expiry of the contract. The limit set by the FCA applies for the entire spot month and is therefore higher than the trading venue limit. It is set at a level to support orderly pricing, and enable price discovery, as well as ensure a smooth transition of positions from the other months period to the spot month period.

Spot month position limit rationale

23. The baseline for the spot month has been set at 20% as required by Article 9(4) of RTS 21 as this is a contract for food intended for human consumption with an open interest of more than 50,000 lots.

24. Although coffee is perishable, no adjustment has been made under Article 20(2)(a) of RTS 21, as coffee can be stored for many years without serious deterioration if stored correctly.

25. No other adjustments have been judged as necessary to be made in the spot month. 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 the FCA has not found evidence that this is excessive or that lower position limits would reduce volatility.

26. This provides a figure in lots of 19,734 which has been rounded down to a figure of 19,700 lots. This equates to a final limit as a percentage of deliverable supply of 20.0%.

Other months' position limit

Open interest

27. The open interest amounts to 143,194 lots. The open interest figure has been reported by the trading venue and is calculated as the daily average over a one year period of the number of open futures and delta-adjusted options contracts which have not been closed out or expired. The period used is the calendar year 2016.

Other months' position limit

28. The other months limit is set at 35,800 of lots, i.e. 25% of open interest. The other months' limit applies to ICE Robusta Coffee Futures and Options contracts

Other months' position limit rationale

29. The baseline for the other months has been set at 25% as required by Article 9(1) of RTS 21.

30. All the potential adjustment factors set out in RTS 21 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 the FCA has not found evidence that this is excessive or that lower position limits would reduce volatility.

31. As no adjustments were made to baseline of 25%, this provides a figure in lots of 35,799 which has been rounded down to a figure of 35,800 lots. This equates to a final limit as a percentage of open interest of 25%.

V. ESMA's Assessment

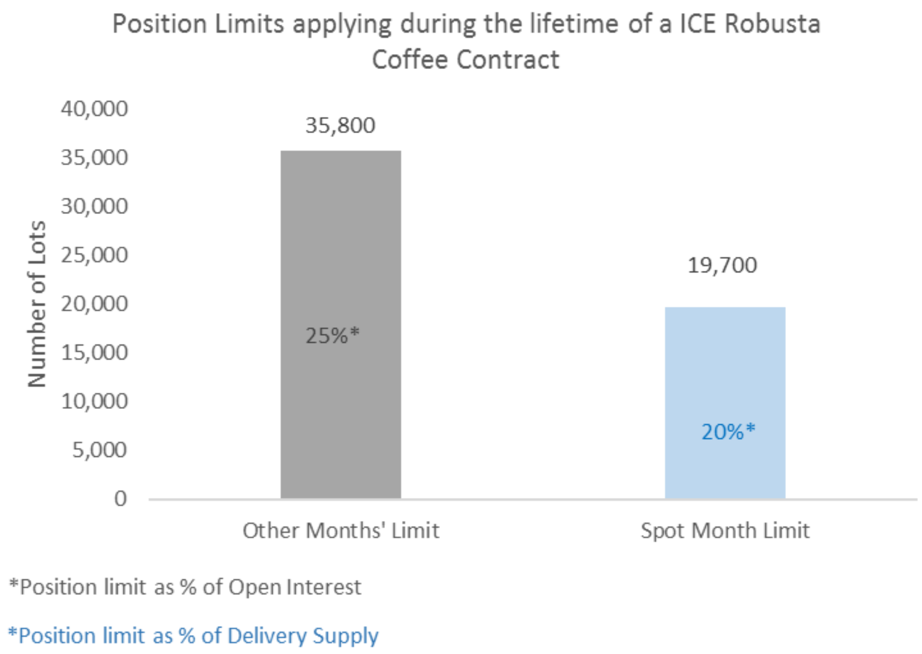
32. This Opinion concerns positions held in Robusta Coffee Futures and Options contracts.

33. ESMA has performed the assessment based on the information provided by the FCA.

34. 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

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



<u>Spot month limit</u>

36. The calculation of the deliverable supply is based on estimates of total production of Robusta Coffee by all exporting companies in 2016 and on average stock data for 2016. As there are six delivery months per year, the annual available deliverable supply has been divided by six. This approach 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".

37. Compared to the baseline figure of 20% of deliverable supply for derivative contracts with an underlying that qualifies as food intended for human consumption with a total interest in spot and other months' contract exceeding 50,000 lots, the position limit has not been adjusted.

38. ESMA agrees that the spot month, which includes up to 60 days, does not qualify as a short maturity requiring a downward adjustment of the spot month limit.

39. ESMA notes that the ICE Robusta coffee future contract is traded on a global basis and agree that the position limits should be set alongside comparable UK global contracts, taking into account the market characteristics of those contracts. In particular, ESMA agrees that compared to other globally traded UK commodity derivative contracts, the number of market participants (146) does not appear high and consequently does not require a downward adjustment under Article 19(1) of RTS 21.

40. ESMA considers that the description provided on the ease and speed of access that market participants have to the underlying commodity does not call either for an adjustment under Article 20(1) of RTS 21. More specifically, given that there are no known constraints on the receipt or delivery of coffee, ESMA agrees that a downward adjustment based on Article 20(2)(b) of RTS 21 is not necessary .

41. ESMA also highlights that, in addition to the spot month limit set by the FCA, ICE has delivery limits that apply in the period immediately prior to the expiry of the contract. Currently, the ICE delivery limit for the ICE Robusta Coffee contracts is set at 7,500 lots and applies by the close of business on the last trading day prior to the first business day of the delivery month. This limit of 7,500 lots will be part of the position management powers of the trading venue. ESMA notes that the ICE delivery limit is significantly lower than the spot month position limit of 19,700 lots set by the FCA. The reason for this is that the spot month limit applies to the whole of the spot month while the trading venue expiry limit applies only to the period immediately prior to the expiry of the contract. The two limits are complementary and will work together without duplication to ensure orderly trading and settlement. The FCA has decided not to duplicate the existing venue delivery limit controls where these are believed to be established and effective as the objective of the delivery limit of the trading venue is only to manage the physical delivery process and to ensure that market participants meet their delivery commitments. The spot month limit is set by the FCA at a level to support orderly pricing, and enable price discovery, as well as to ensure a smooth transition of positions from the other months' period to the spot month period.

<u>Other months' limit</u>

42. The open interest was calculated as the daily average over a one-year period of the number of open contracts that have not been closed out or expired. The period used is the calendar year 2016. ESMA considers such an approach as sensible in this case as an average for a period of time gives a more stable measure of open interest and considers such an approach as consistent with Article 12 of RTS 21.

43. Compared to the baseline figure of 25%, the position limit has not been adjusted, as none of the adjustment factors listed in RTS 21 was regarded as relevant or material by the FCA. As for the spot month limit, ESMA notes at the ICE White Sugar contract is traded on a global basis and agree that the position limit should be set alongside comparable UK global contracts, taking into account the market characteristics of those contracts.

44. In particular, compared to other globally traded UK commodity derivative contracts, the approach by which the amount of open interest (252,770 lots) does not appear high and consequently does not require a downward adjustment under Article 18(1) of RTS 21 appears reasonable.

45. ESMA also considers reasonable that the reasons set out above in the analysis of the spot month limit for not taking into account other adjustment factors apply to the other months' limit as well.

46. Finally, ESMA notes that the amount of open interest (143,194 lots) is not significantly higher than deliverable supply (98,669 lots) and agrees that a downward adjustment is not justified here under Article 18(2) of RTS 21.

47. 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

48. 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) of MiFID II.

49. Overall, the position limit set for the spot month and the other months, in conjunction with the position management powers of the trading venue, appear to achieve a reasonable balance between the need to prevent market abuse and to ensure orderly pricing and orderly settlement, while also ensuring that the development of commercial activities in the underlying Robusta coffee market and the liquidity of the ICE Robusta Coffee futures and options contracts are not hampered.

VI. Conclusion

50. Based on all the considerations and analysis presented above, it is ESMA's opinion that the 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, 24 October 2017

Steven Maijoor

Chair

For the Board of Supervisors