esma European Securities and Markets Authority

Reply Form to the Consultation Paper

MiFID II review report on position limits and position management
Draft Technical Advice on weekly position reports

5 November 2019

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **8 January 2020.**

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'. Please follow the instructions given in the document 'Reply form for the consultation paper on "MiFID II review report on position limits and position management and draft technical advice on weekly position reports' also published on the ESMA website.

Instructions

In order to facilitate analysis of responses to the Consultation paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation paper in the present response form.

2. Please do not remove tags of the type <ESMA_QUESTION_WPR_1>. Your response to each question has to be framed by the two tags corresponding to the question.

3. If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.

4. When you have drafted your response, name your response form according to the following convention: ESMA_WPR_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_WPR_ABCD_RESPONSEFORM.

5. Upload the form containing your responses, in Word format, to ESMA's website (www.esma.europa.eu under the heading "Your input – Open consultations" → "Call for Evidence on Position limits and position management in commodities derivatives").

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading Legal Notice.

Who should read this paper

All interested stakeholders are invited to respond to this consultation paper. This consultation paper is primarily of interest to trading venues, investment firms and non-financial counterparties trading in commodity derivatives, but responses are also sought from any other market participant including trade associations, industry bodies and investors.

General information about respondent

Name of the company / organisation	BDEW e.V.
Activity	Non-financial counterparty
Are you representing an association?	☒
Country/Region	Germany

Introduction

Please make your introductory comments below, if any

<ESMA_COMMENT_WPR_1>

TYPE YOUR TEXT HERE

<ESMA_COMMENT_WPR_1>

Questions

Part I

Q1 : Which option (Option 1 or Option 2) do you support for dealing with competing contracts? Please explain why. If you support Option 1, do you have any suggestions for amending the definition of "same contract" in Article 5(1) of RTS 21? If you support another alternative, please explain which one and why.

<ESMA_QUESTION_WPR_1>
BDEW favours Option 2 as an approach where limits remain separate and continue to be set by the respective national competent authorities (NCAs) to implement and monitor as a simple alternative to the establishment of a joint limit. Allowing the NCA of the less liquid trading venue(s) to set the other months' limit at 25% of the open interest on the most liquid market will be an effective mechanism to promote a level playing field between trading venues and adequate choice to market participants.
<ESMA_QUESTION_WPR_1>

Q2 : Do you agree that the C(6) carve-out creates an unlevel playing field across trading venues and should be reconsidered? If not, please explain why.

<ESMA_QUESTION_WPR_2>
BDEW strongly disagrees that the C(6) carve-out creates an unlevel playing field across trading venues and would like to explain in detail:

Substantial differences between the energy sector and the financial sector:

Physical wholesale energy trading is subject to the REMIT regulatory framework because of the substantial differences between the energy sector and the financial sector, which ESMA has not been considering.

- Whereas in the financial sector a systemic risk (as manifested in the financial crisis) is present, the energy sector poses no systemic risk to the financial market. There is no substantiate evidence that physical gas and power contracts pose a threat to the well-functioning of the financial market.

- Furthermore, wholesale energy trading takes place between trading professionals and aims at managing supply and demand, whereas in the traditional financial sector investor protection is needed.

- The differences between the financial and the energy sector materialise even more when it comes to the overall trading approach and objective. Energy companies provide the market liquidity that the energy and real economy need to reduce their commercial (commodity price) risks efficiently, by selling or buying the power and gas at market prices. Hence, energy firms' trading activities are key to ensure a secure, sustainable and competitive energy supply to end consumers.

As a result, the transparency requirements differ, as the energy sector is exposed to specific regulation such as REMIT and the Third Energy Package to deal with transparency (i.e. trade transparency, fundamental transparency) in the wholesale energy market in gas and power.

The MiFID C(6) carve-out has been a well-considered exemption by EU stakeholders:
Wholesale energy trading in gas and power is subject to REMIT regime, which is a specific and tailored regulation. The removal of the C(6) carve-out would render the REMIT regulation almost useless as to a large part it is focused on the physical energy markets.
Under the current REMIT regime, the C(6) carve-out contracts are supervised under a tailored regime through a specialised authority, which ensures the well-functioning of the gas and power markets. The C(6) carve-out contracts are used to hedge merchant risk to manage supply and demand. Market participants need to be able to deliver or take delivery of the contract or they will be subject to sector specific imbalancing procedures.
The REMIT framework is robust and ensures market transparency and integrity: Each transaction is subject to REMIT reporting which guarantees transparency in the physical market. REMIT foresees access to the transaction data to Financial Regulators should there be a concern that the activity on the physical market has an impact on the financial market. Furthermore, REMIT provides for the disclosure of inside information as well as the prohibition of market manipulation and insider trading.
Detrimental consequences of a removal of the MiFID C(6) carve-out
Removing the REMIT carve-out would have major detrimental consequences to the treatment of wholesale energy products under various regulations, triggering unintended negative consequences. It will not only lead to a significant increase in costs for market participants, but also to a loss of competitiveness of EU energy markets and severe impacts on wholesale energy market functioning and market participation. The impacts identified so far are the following:

- The scope of REMIT market abuse prohibitions would be drastically reduced, directly impacting the scope of market abuse supervision of well-established energy regulators (NRAs and ACER), whereas it provides today a comprehensive and adequate sector-specific regulation to guarantee transparency and market integrity of wholesale energy markets (with provisions in respect of trade reporting, transparency and market abuse).

A)

- Material impact on the EMIR risk-reducing framework of non-financial counterparties. Financial derivative transactions can only be considered as “risk reducing” if they work directly related to the commercial (non-financial) activity or treasury financing activity of the non-financial counterparty or of that group. If the majority of the commercial activity of an industrial commodity dealer becomes financial – as a result of the requalification of OTF traded physical forward (C6) and bilateral physical forward (C7) as financial instruments – many current non-financial counterparties in the wholesale energy market will no longer be able to demonstrate the risk reducing nature of their hedges related to physical flows. As a result, they would breach the EMIR clearing threshold.

  Breaching the EMIR clearing threshold triggers mandatory margining obligations and other more stringent risk mitigation measures (including daily Mark to Market). Not only the core physical commercial activity of NFCs will be impacted, but these firms will no longer offer physical hedging services to their customers as well.
  On the other hand, requalifying such trades will not bring any additional transparency to the market as all transactional data in respect to wholesale energy products is currently already reported to ACER. EU and national supervisors should collaborate and share information wherever it is available without requiring duplicative reporting of market participants.
- The EMIR risk reducing definition is also used to determine which trades are “privileged” transactions for the Ancillary Activity test under MiFID. Hence, it will impact the capability of wholesale energy market participants to demonstrate that they comply with the Ancillary Activity Exemption criteria. Forcing industrial groups to apply for a MiFID authorisation,

including all organisational requirements, conduct of business rules and significant capital requirements that will start applying under the newly adopted Investment Firm Regulation.

Without the C(6) carve-out, trading entities of energy groups may consequently have to turn into investment firms, resulting into higher costs of doing business which will, at least partially, be passed through to energy consumers across the economy. This increase in costs is not justified by the increased level of supervision, given the clear lack of systemic risk posed by commodity traders.

In order to avoid becoming an investment firm, energy groups may reduce the amount of hedging they perform. Such reduced ability to manage their merchant risk will result in a higher premium charged to their customers. Alternatively, they may resort to hedging through non-standardized contracts if available, resulting once again in higher costs that will be passed through.

As of today, energy utilities and industrial clients often only cover their risks via physical (and non MiFID relevant) transactions and would – after the deletion of C(6) – become subject of the entire set of rules of financial regulation. This includes arranging reporting of transactions through trade repositories, agreeing conditions for several risk mitigation techniques, start calculating EMIR and MiFID thresholds, applying for a MiFID exemption, start arranging position and transaction reporting for the TVs, central clearing and/or collateralization under EMIR etc.

Therefore, small and medium sized energy companies may cease to trade on the wholesale market as it would be too burdensome and would bind too many resources. The effect would be a decrease in competition.

The increase in regulatory and compliance costs for the real economy would also affect medium and large non-financial entities. In fact, the carve-out removal would artificially increase their level towards EMIR thresholds (unless ESMA revise them), with two possible consequences:

- These firms may cut their activity on physical markets, to the detriment of the liquidity of such markets and with a consequent increase of hedging costs for all the participants in those markets.
- Otherwise, they could breach EMIR thresholds, in which case they would have to face the high cost of clearing and margining obligations.

B)

This scenario might negatively affect the ability of energy companies to invest in the real economy, jeopardising their role in the fight to climate change and in the transition towards a more sustainable economic and energy system.

MiFID II caused no move of liquidity away from regulated markets

ESMA states on page 23 that: "*ESMA shares the concerns expressed by some respondents with regard to the shift of trading in physically-settled wholesale energy contracts (REMIT contracts) from regulated markets and MTFs to OTFs post-MiFID II as a result of the C(6) carve-out and the unlevel playing field this exemption has created*."

However, no quantitative data supports ESMA's statement. Contrary, the data that is publicly available https://www.trayport.com/category/market-dynamics-report/? shows that the opposite has happened and that the market share of exchange executed transactions in gas and power has grown since the implementation of MiFID II. By introducing OTFs, MiFID II just provided formalization of the previously (MiFID I) non-MTF broker platforms: The physical gas and power products have been out of scope of financial regulation since MiFID I, because they were traded on non-MiFID I regulated broker platforms (so-called non-MTF brokers). It is

therefore, factually wrong to state that these trading in physically-settled wholesale energy contracts shifted from MiFID regulated platforms to OTFs.

The chart below shows the Trayport monthly data since 2011 for gas and power.

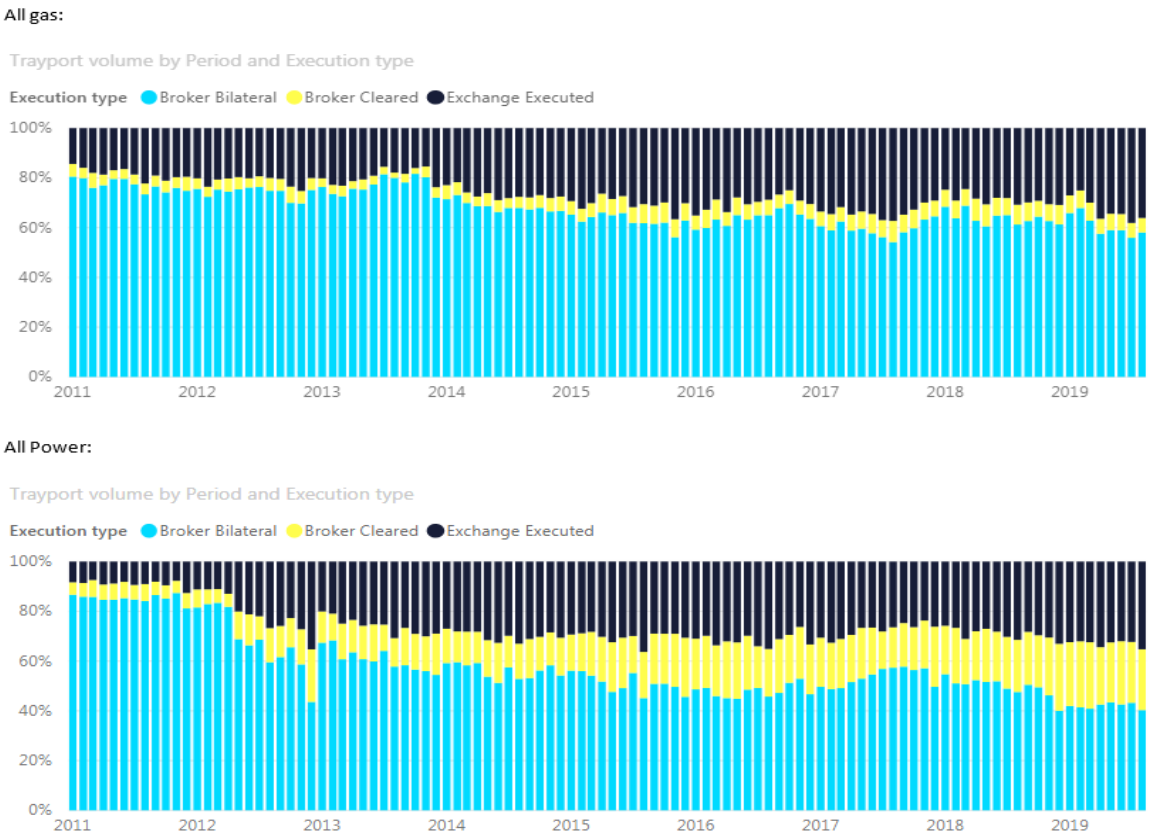

Figure 1: JEAG

The data shows that compared with 2018 in 2019 (YTD August) the market share of exchange traded gas and power products has grown by 4%.

<ESMA_QUESTION_WPR_2>

Q3 : Do you agree that the position limit framework should not apply to securitised derivatives? If not, please explain why.

<ESMA_QUESTION_WPR_3>

BDEW members are not active in this market segment.

<ESMA_QUESTION_WPR_3>

Q4 : Which option do you support to address the negative impact of position limits on new and illiquid commodity derivatives: Option 1 or Option 2? Please explain why. If you support another alternative, please explain which one and why.

<ESMA_QUESTION_WPR_4>

Refocusing the scope of the position limit regime to a limited set of critical contracts is a more effective tool to address the negative impact of position limits on new and illiquid contracts and would deliver a much-needed simplification of the regime without significantly impacting its

effectiveness in terms of market abuse prevention and market transparency. Therefore , BDEW supports Option 1.
A refocus of the systems is justified as the price formation mainly occurs in benchmark products. Only insofar, it seems necessary and appropriate to reduce the potential threat of market manipulation. Finally, this would create a regulatory level-playing field between the EU and US commodity markets and protect the liquidity and competitiveness of EU commodity markets.
On the other hand, an increase of limits on illiquid contracts to 50% of the reference amount would represent a slight improvement of the current situation but by no means a guarantee that the difficulties with new and illiquid will be overcome.
<ESMA_QUESTION_WPR_4>

Q5 : If you support Option 1 and would suggest different or additional criteria to determine whether a contract qualifies as a critical contract, please explain which ones.

<ESMA_QUESTION_WPR_5>
BDEW agrees with the criteria listed by ESMA. A combination of quantitative (open interest, number of market participants) and qualitative (type of market participants, characteristics of underlying market) criteria is the preferable approach.
In order to ensure stability in the position limit regime, we suggest that the relevant assessment is performed by NCAs and ESMA annually based on a three-year rolling average of the relevant indicators.
<ESMA_QUESTION_WPR_5>

Q6 : Which open interest and participant threshold would you suggest for qualifying a commodity derivative as a critical one?

<ESMA_QUESTION_WPR_6>
Thresholds should only be defined after extensive stakeholder consultation to ensure that all relevant elements and views are taken into account. In particular, the view of trading venues should be taken into special consideration because they have the best understanding of the markets they operate and possess a vast amount of information about participants, orders and trades.
<ESMA_QUESTION_WPR_6>

Q7 : Would you support a position limit exemption for financial counterparties under mandatory liquidity provision obligations? If not, please explain why.

<ESMA_QUESTION_WPR_7>
BDEW supports the introduction of a position limit exemption for financial counterparties under mandatory liquidity provision obligations. However, such an exemption should be available to both financial and non-financial counterparties. We do not see any valid reason why the scope of the exemption should be limited to investment firms.
The exemption should mirror the treatment of liquidity provision arrangements in the Ancillary Activity Exemption test stipulated by Delegated Regulation 2017/592.
<ESMA_QUESTION_WPR_7>

Q8 : Would you support introducing a hedging exemption for financial counterparties along the lines described above? If not, please explain why.

<ESMA_QUESTION_WPR_8>

BDEW supports the introduction of a position limit hedging exemption for financial counterparties belonging to a predominantly commercial group.
The extension of the hedging exemption to these new counterparties should also be the opportunity to review and harmonise the application process:
BDEW urges ESMA (see our response to the Call for Evidence) again to promote greater coordination in the implementation of hedging exemptions across the EU, including a more harmonised application process for market participants. Some NCAs impose quantitative limits to hedging exemptions, unnecessarily increasing the administrative burden for market participants that face greater hedging needs (for instance, due to an increase in the production of the underlying commodity) and are forced to file new applications. Market participants which demonstrate the hedging need, should be granted a hedging exemption without quantitative limits. As NCAs can continue to monitor the use of the exemption on the basis of the daily position reports, the robustness of the regime and the supervisory capabilities of the NCAs would be unaffected.
<ESMA_QUESTION_WPR_8>

Q9 : Do you agree with ESMA's proposals to amend Article 57(8)(b) of MiFID II and to introduce Level 2 measures on position management controls? If not, please explain why.

<ESMA_QUESTION_WPR_9>
While a one-size-fits-all approach may be difficult to calibrate, we see merits in establishing a set of measures that would provide a minimum standard with which all trading venues must comply, i.e., a more concrete and harmonised position management regime for all EU trading venues. We agree with ESMA, that in Level 1 of MiFID II should be introduced, that ESMA can draft Level 2 measures for a concrete and harmonised position management regime accordingly. Given the wide variety of market structures and specificities across different commodity derivative markets, such Level 2 measures should not be overly prescriptive and should empower trading venues to make a choice between appropriate enhanced position management controls if deemed necessary (accountability levels and setting of position levels mentioned in the ESMA consultation).
<ESMA_QUESTION_WPR_9>

Part II

Q10 : Do you agree with the revised proposed minimum threshold level for the open interest criterion for the publication of weekly position reports? If not, please state your preferred alternative for the definition of this threshold and explain why.

<ESMA_QUESTION_WPR_10>
BDEW agrees with the revised minimum threshold level proposed by ESMA for the publication of weekly position reports. The publication of more weekly position reports is welcome as long as the confidentiality of trading strategies and other key business decisions continues to be preserved. This means that at least 4 different position holders must be trading in a specific contract to achieve that goal.
<ESMA_QUESTION_WPR_10>

Q11 : Do you have any comment on the current number of position holders required for the publication of weekly position reports?

<ESMA_QUESTION_WPR_11>
BDEW believes that the current number of 20 position holders required for the publication of weekly position reports could be reduced (to e.g. 10 position holders) without materially impacting the orderly pricing and orderly settlement of commodity derivative markets.
<ESMA_QUESTION_WPR_11>