

OPINION on position limits on EEX Supramax TC 10 Freight contracts

I. Introduction and legal basis

1. On 29 May 2020, the European Securities and Markets Authority (ESMA) received a notification from the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments¹ ("MiFID II") regarding the exact position limits BaFin has set for the EEX Panamax TC Freight 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 derivatives² ("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)³ ("ESMA Regulation"), the Board of Supervisors has adopted this opinion.

II. Contract classification

Commodity base product: freight (FRGT)

Commodity sub product: dry (DRYF)

Commodity further sub product: dry bulk carriers (DBCR)

Name of trading venue: EUROPEAN ENERGY EXCHANGE

MIC: XEEE

Venue product codes: STCM, OTSM

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 1.12.2016 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. The EEX Supramax TC 10 Freight Futures and Options contracts are cash settled dry time-charter freight contracts. Their underlying is the price representing the straight average of rates for hiring on a time charter basis for four routes per vessel of the Supramax class. They do not include any specifications for physical delivery for this commodity derivative contract
4. The underlying is the price for the hiring of a vessel for a specific period of time for a specific route. In case of the Supramax Time Charter (STC) the vessel is a dry bulk ship of the Supramax class. These vessels have a capacity between 50,000 and 60,000 dwt (dead weight tons) and are usually equipped with five cargo holds and deck cranes with a lifting capacity between 25t and 40t. STCM and OTSM contracts of the EEX cover the average price of ten routes for one day:
 - S1B (Canakkale to China/South Korea)
 - S1C (US Gulf to China)
 - S2 (North China to Australia)
 - S3 (North China to West Africa)
 - S4A (US Gulf to Skaw Passero)
 - S4B (Skaw Passero to US Gulf)
 - S5 (West Africa via East Coast South America to North China)
 - S8 (South China via Indonesia to East Coast India)
 - S9 (West Africa via East Coast South America to Skaw Passero)
 - S10 (South China to Indonesia)
5. The prices are based on the prices as published by the Baltic Exchange that also provides the Baltic Dry Index which is a composite of all routes and vessel types and prices for the individual routes per vessel type. Panels of independent shipbrokers around the world give their judgement as to the prevailing level of the open market within the parameters of the route they have been asked to assess.
6. BaFin is not aware of any restriction on the supply of the underlying. It is estimated that there were approximately 2,800 vessels in active operation during 2019. The control of these vessels is highly diversified with hundreds of different market participants responsible for their operation. Further, it is estimated that even the largest owners/operators in this segment control as maximum less than 5% of total supply. It is not considered possible that supply can be restricted.



7. BaFin is not aware of any restrictions on the delivery of the underlying. Also, given that the contract is cash settled there are no specification for physical delivery for this commodity derivative contract.
8. The supply side of the physical market is the ship owners and ship operators. The demand is the charterers and cargo owners such as mining companies, grain houses, commodity trading companies and energy companies. Many of the market participants in the physical market are also active in the commodity derivative market, however there are still many ship owners and demand side players worldwide who are not using freight rate derivatives to hedge their physical exposure to the freight rates. Generally, the market structure is very fluid, i.e. one entity may be at the same time owner, operator and charterer.
9. The physical supply does not fluctuate over the calendar year. The supply is mainly influenced by the construction and delivery of new vessels into the fleet (newbuilding prices in relation to freight rates perspective) and the removal of vessels for scrapping or conversion to other ship types.
10. The demand side in case of dry bulk is mainly driven by growth of the world economy. Dry bulk prices are often used as indicator of economic trends.

IV. Proposed limit and rationale

Spot month position limit

11. The EEX Supramax TC 10 Freight Futures and Options contracts are freight contracts under Article C (10) of Annex I to Directive 2014/65/EU. According to Position Limit 10 of the ESMA Q&A on position limits both in the spot month and in the other months should be based on open interest.

Open interest

12. Open interest amounts to 16,550 lots.
13. EEX has acquired Nasdaq Futures Inc.' (NFX) set of dry freight contracts with effect from 12 December 2019. At this date all trading at NFX ceased and continued at EEX. During the preceding weeks most trading members had therefore migrated their positions to EEX. Furthermore, trading members were required to announce the number of positions they were to migrate to EEX until 21 November 2020.
14. Open interest value was provided by the exchange. It was calculated as the sum of the migrated positions as announced by former NFX's trading members as of 21 November 2019 and the average size of daily open interest throughout three consecutive months (July, August, September 2019) at EEX. The open interest of the options has been calculated according to their delta equivalents.

Spot month position limit



15. Spot month limit amounts to 4,139 lots, which represents 25% of open interest. The spot month limit applies to EEX Supramax TC 10 Freight Futures and Options contracts.

Spot month position limit rationale

16. As the underlying of the EEX Supramax TC 10 Freight Futures/Options contract does not qualify as food intended for human consumption, the baseline figure for the spot month is set at 25% of the reference amount, i.e. open interest, in accordance with Article 9 of RTS 21 ($25\% * 16,550 \text{ lots} = 4,139 \text{ lots}$). There is no market maker active. Thus, the limit is to be set within a range of 5% - 50%. Spot month is the next calendar month which is available to trade. The spot month period only includes one monthly contract.
17. After considering all the characteristics of the contract, BaFin has decided not to make any adjustments under any of the Articles of RTS 21. No factors that would justify an adjustment from the baseline, either up or down, have been identified.
18. In considering the volatility in the contract, as required by Article 21 of RTS 21, BaFin noted that there has been some variation in the price of the commodity derivative but BaFin has not found evidence that this is excessive or that lower position limits would reduce volatility.
19. As no adjustment was made to the baseline, this results in a spot month limit of 4,139 lots, which equates to 25% of open interest.

Other months' position limit

Other months' position limit

20. The other months' limit amounts to 4,139 lots, which represents 25% of open interest. The other months' limit applies to the EEX Supramax TC 10 Freight Futures and Options contracts.

Other months' position limit rationale

21. As the underlying of the EEX Supramax TC 10 Freight Futures/Options contract does not qualify as food intended for human consumption, the baseline figure for the spot month is set at 25% of the reference amount, i.e. open interest, in accordance with Article 9 of RTS 21 ($25\% * 16,550 \text{ lots} = 4,139 \text{ lots}$). There is no market maker active. Thus, the limit is to be set within a range of 5% - 50%. Spot month is the next calendar month which is available to trade. The spot month period only includes one monthly contract.
22. All potential adjustment factors have been considered by BaFin and, based on the characteristics of the contract, are not regarded as material or relevant to require additional adjustments, either up or down, from the baseline.



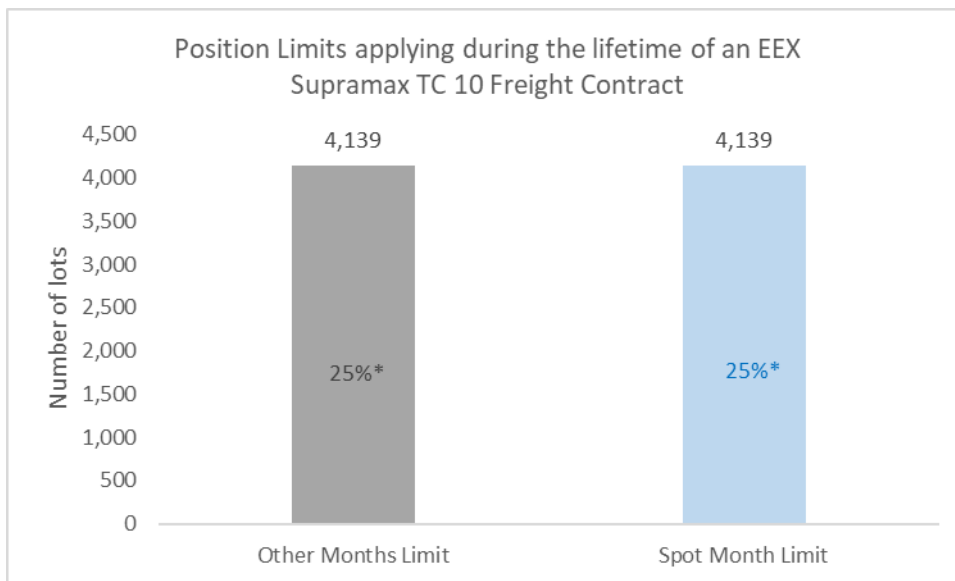
23. In considering the volatility in the contract, as required by Article 21 of RTS 21, there has been some variation in the price of the commodity derivative but BaFin has not found evidence that this is excessive or that lower position limits would reduce volatility.
24. As no adjustment were made to the baseline, this results in a spot month limit of 4,049 lots, which equates to 25% of open interest.

V. ESMA's Assessment

25. This Opinion concerns positions held in EEX Supramax TC 10 Freight Futures/Options contracts.
26. ESMA has performed the assessment based on the information provided by BaFin.
27. Since the contract was traded before on Powernext until the end of 2019, when the merger between EEX and Powernext took place, ESMA considers that this is a continuation of trading in the previously existing contract, rather than a new contract. Therefore, it seems appropriate to use the previously observed OI level on Powernext, for the purpose of setting the relevant position limits.
28. ESMA notes that the EEX Supramax TC 10 Freight Futures and Options contract is a recently liquid contract for which bespoke position limits are established by BaFin for the first time.
29. ESMA notes that when BaFin notified ESMA, the position limits for the EEX Supramax TC 10 Freight Futures/Options contracts had already been set and active.
30. 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

31. BaFin has set the same position limit for the spot month and for the other months'.



*Position limit as % of Open Interest

32. ESMA agrees that EEX Supramax TC 10 Freight Futures and Options contracts are freight contracts under Article C(10) of Annex I of MiFID II and that, accordingly, the spot month limit is to be set as a percentage of the open interest in those contracts.
33. The open interest was calculated as the sum of the migrated positions as announced by former NFX's trading members as of 21 November 2019 and the average size of daily open interest throughout three consecutive months (July, August, September 2019). ESMA considers that such an approach is sensible in this case as it allows better taking into account the upward trend in open interest. ESMA also considers this approach to be consistent with Article 12 of RTS 21.
34. ESMA considers in particular as a reasonable approach not to have adjusted the spot month limit downwards based on the characteristics of the contract.

Other months' position limit

35. ESMA agrees that most of the potential adjustment factors in RTS 21 are not relevant for cash settled contracts where open interest serves as a baseline both for the spot month and for the other months'.
36. 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

37. Under Article 57(1) of MiFID II, the objectives of the position limits are to prevent market abuse and support orderly pricing and settlement conditions including preventing market distorting positions.

38. Based on the information provided by the competent authority, ESMA notes that the spot month limit for the EEX Supramax TC 10 Freight contracts exceeds the highest open interest in the spot month during the reference period considered. There is a risk that the objectives set out in Article 57(1) of MiFID II may not be achieved where the limit set for the spot month is well above the positions held by market participants.
39. In light of the assessment above, ESMA considers that the position limits set for the spot month and for the other months 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 power market and the liquidity of the EEX Supramax TC 10 Freight contracts futures and options contracts are not hampered
40. However, to help ensure that the risk of not achieving the objectives set out in Article 57(1) of MiFID II does not materialise, ESMA considers that trading patterns in the EEX Supramax TC 10 Freight contracts should be carefully monitored by the competent authority, in particular during the spot month, and that the spot limit should be reviewed on a timely basis.

VI. Conclusion

41. 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. This 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,

Steven Maijoor

Chair

For the Board of Supervisors