Date: 24 October 2017
ESMA70-155-1832

OPINION on position limits on TIN contracts

I. Introduction and legal basis

1. On 4 August 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[1] ("MiFID II") regarding the exact position limits the FCA intends to set for the tin 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: metals (METL)

Commodity sub product: non-precious (NPRM)

Commodity further sub product: tin (TINN)

Name of trading venue: THE LONDON METAL EXCHANGE

MIC: XLME

Venue product code: SN

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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. Tin is a metal, non-perishable and is most commonly used for solder and the plating of iron and steel products. The largest deposits are found in China, Indonesia, Brazil, Bolivia, Russia, Peru and Malaysia.[4]

4. The largest producer of refined tin is China followed by Indonesia, Malaysia, Peru, Bolivia and Brazil. Refined production is around 350,000 tonnes per annum. Global annual tin production from mines is a lower figure of around 315,000 tonnes, reflecting the use of recycled metal in producing refined tin.[5] China is also the largest consumer of refined tin, importing a small quantity above the volume of domestic production. The next most significant consumers are the industrialised nations of the United States, Japan and Germany. There is no particular seasonality noted in production or consumption of the metal which leads to price fluctuation.

5. The market features a wide range of participants including producers hedging their output, industrial consumers, market intermediaries and longer term investors in commodities such as funds. The global nature of the metals markets and the associated warehousing system means that stocks held outside the London Metal Exchange (LME) system can be rapidly introduced to meet delivery obligations.

6. The LME has a network of warehouses located across many countries from which the underlying commodity may be sourced. There are 20 approved LME brands of tin.

7. All tin must be of an LME approved brand to be deliverable against LME contracts. LME tin contracts are physically settled via the LME's warehouse network which includes 600 LME approved warehouses.

8. The FCA is not aware of any material restrictions on the transportation of tin from the relevant warehouses.

9. In addition to the LME, tin futures are traded on SHFE (Shanghai Futures Exchange). The SHFE contract is physically settled. Major producers and refiners are significant users of the commodity derivatives markets.

10. According to the World Bank, in 2016, tin prices rose driven by strong demand and supply constraints. Shipments from Indonesia—the world's second largest exporter— plunged because of the impact of wet weather on production and transportation, and from government regulations regarding illegal mining and reserve depletion. Exports from Myanmar continue to help replace the shortfall, and Bolivian production is set to rise. New supplies are also ex-

[4] Royal Society of Chemistry, Periodic Table Tin, http://www.rsc.org/periodic-table/element/50/tin and World Bank Commodity Markets Outlook, January 2017
[5] World Bank Commodity Markets Outlook, January 2017

pected from Africa, Australia, and Brazil, and higher prices could also reactivate idled capacity.[6]

11. Estimated number of market participants / market makers in accordance with Article 19(2) of RTS 21: 235 / 0

IV. Proposed limit and rationale

Spot month position limit

12. Deliverable supply amounts to 7,432 lots. A lot is equivalent to 5 Tonnes.

13. The contract is settled by transfer of a claim to (or "warrant" over) physical metal. The starting point for calculation of deliverable supply against the LME contract is the published data on stocks of metal held in LME warehouses. The information on LME Official Stocks is available to any person from the LME website[7]. The average of daily levels of LME Official Closing Stock for the calendar year 2016 was 945 lots of the tin contract. This represents the most immediate stock of the commodity which is available for physical delivery.

14. Deliverable supply is, however, represented not only by reported stocks but also a number of other elements which could be used to meet the delivery obligation. These include cancelled warrants cover metal that may have been taken out of the LME system either to reduce storage charges, in anticipation of movement out of a warehouse, or for other operational reasons. Cancelled warrants may be reinstated on an almost immediate basis by the warehouse-keeper on instruction from the metal-owner. LME warrants may also be delivered multiple times during the spot month period, because of the LME practice of daily settlement. This further increases the quantity of potential deliverable supply. The re-use of LME warrants to meet delivery obligations is an established characteristic of the LME markets which enables participants to match their requirements for physical metal in specific locations. It also enables the timing of deliveries to take place outside the normal “Third Wednesday” monthly trading cycle which defines the spot month period for the purpose of setting limits.

15. The spot month is defined as the amalgamation of all daily prompts within the 30 days immediately preceding the relevant month’s expiry as this takes into account only trading linked to the relevant expiry month.

16. An additional source of deliverable supply is unwarranted tin that is held by LME warehouse companies in their non-LME licensed warehouses and which can easily be transferred into their LME licensed warehouses and placed on warrant. Often, LME warehouse companies have LME-licensed and non-LME warehouses at the same location. Additional space within LME warehouses allows metal which is not currently within the LME system to be introduced and made eligible for delivery.

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[6] Ibidem
[7] https://www.lme.com/metals/reports/stocks/

17. These additional factors mean the amount of metal calculated to be in the deliverable supply is greater than the amount recorded as on LME warrant at any point in time. The amount of monthly global production of refined tin represents around 5,833 lots of the LME contract[8], which is much larger than the amount calculated as deliverable against the LME tin contract.

18. In calculating deliverable supply, the FCA has excluded quantities of metal which are committed by commercial entities under long-term arrangements to supply or purchase. These amounts are therefore not available to enter the LME stock system.

19. In summary, the breakdown of the components for calculating deliverable supply using data for the calendar year 2016 are:

Deliverable Supply	**Number (Lots)**	**Notes**
LME Warehouse Stocks	945	On-warrant and cancelled warrants
Deliverable non-LME Warehouse Stocks	4,009	Excluding non-LME branded eligible metal
Monthly Production in LME branded metal	1,068	Excluding production that would be used for commercial and alternative purposes
Re-use of LME Warrants at LME Warehouses	1,410	To reflect multiple use of warrants to settle contracts during spot period
Total	*7,432*	

Deliverable non-LME Warehouse Stocks figures from estimates provided by LME

Spot month position limit rationale

20. The spot month limit is 1,700 lots and represents 22.9% of the deliverable supply.

21. The baseline for the spot month limit has been set at 25% of deliverable supply as required by Article 9(1) of RTS 21.

22. Adjustments have been made to the baseline, where necessary, using the rationale for adjustments set out in RTS 21 as follows.

23. While a supply of metal is also needed to settle other trading venues' contracts, trading volumes at these other trading venues is relatively small (3,498 equivalent lots) compared with LME trading. The FCA has therefore made a downward adjustment of 1 percentage point under Article 17 of RTS 21, to the limit, to reflect trading at other venues.

24. The FCA made a downward adjustment of 1 percentage point to reflect the estimated large number of market participants (235) in accordance with Article 19(1) of RTS 21.

[8] World Bank Commodity Markets Outlook, January 2017

25. Each of the factors referred to in Article 20 of RTS 21, also was considered but no further adjustment was considered necessary.

26. For the spot month, a total downward adjustment was made of 2 percentage points resulting in an adjusted baseline of 23%. This provides a figure in lots of 1,709 which has been rounded down to a figure of 1,700 lots. This equates to a final limit as a percentage of deliverable supply of 22.9%.

Other months' position limit

Open interest

27. The open interest amounts to 21,260 lots. A lot is equivalent to 5 tonnes.

28. 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.

29. This is not a "same" commodity derivative contract so there is no requirement to aggregate the open interest on multiple trading venues.

Other months' position limit rationale

30. The other months limit amounts to 4,750 of lots and represents 22.3% of the open interest.

31. The baseline for the other months has been set at 25% of open interest as required by Article 11 of RTS 21.

32. The FCA considers the amount of the open interest to be large in relation to deliverable supply (286%), and therefore have made a downwards adjustment of 1.5 percentage point under Article 18(2) of RTS 21.

33. The FCA made a downwards adjustment of 1 percentage point under Article 19(1) of RTS 21 to reflect the estimated large number of market participants (235).

Further Comments

34. 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. Although there are no market makers, as defined in RTS 21, in tin according to the data provided by the venue and this would at first sight suggest that the upper limit boundary to the position limit would be 50% (according to Article 19(2) of RTS 21), as there are many liquidity providers fulfilling an analogous role to market makers such an upward adjustment is not necessary. In considering the volatility in the contract, as required by Article 21 of RTS 21, there has been some varia-

tion 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.

35. For the other months, a total downward adjustment was made of 2.5 percentage points resulting in an adjusted baseline of 22.5%. This provides a figure in lots of 4,784 which has been rounded down to a figure of 4,750 lots. This equates to a final limit as a percentage of open interest of 22.3%.

V. ESMA's Assessment

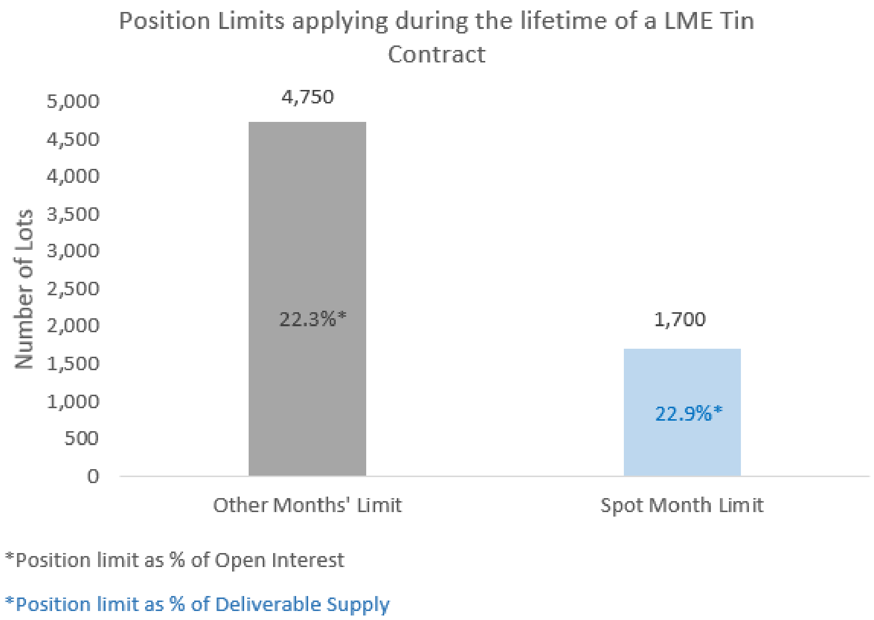
36. This Opinion concerns positions held in tin futures and options contracts.

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

38. 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

39. The FCA has set two position limits. One for the entire spot month, and one for the other months.



Spot month position limit

40. Deliverable supply has been calculated by assessing a combination of factors that all contributed to the average monthly amount of the underlying commodity for delivery. In this case (1) average daily LME warehouse stocks, (2) deliverable non-LME warehouse stocks, (3) monthly production in LME branded metal and (4) re-use of LME warrants at LME warehouses.

41. ESMA recognizes that the 're-use of warrants' market practice is particular to individual contracts and not ubiquitous across all LME contracts. The existence of the activity is dictated by the prevailing market nature and conditions, and as such will not be included in all deliverable supply calculations.

42. ESMA considers that this approach is consistent with Article 10(2) of RTS 21 that 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".

43. While the metal supply within 'non-LME warehouses' is not immediately available for delivery, ESMA accepts that it can be easily transferred into licensed warehouses, and accordingly their stock can be added to the deliverable supply.

44. ESMA also considers the adjustments made under Article 17 of RTS 21 for the use of deliverable supply being required to fulfil other metal contracts as appropriate.

45. ESMA notes that LME metals contracts are 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. As such, the level of adjustments was considered with reference to other metal contracts, and seems appropriate. The large number of market participants indicate high activity in trading in aluminum contract, thus the more strict spot month limit should not cause an impairment to trading in this commodity, while limiting the possibility of single participant to have large impact on prices.

Other months' position limit

46. The open interest was calculated as the average daily value of open interest over 2016 of contracts that have not expired or been closed out.

47. ESMA considers such an approach sensible in this case as an average for a period of time gives a more stable measure of open interest and considers such approach consistent with Article 12 of RTS 21.

48. The adjustments made with reference to large open interest and number of market participants can be explained by large volume of trading, which indicate that stricter limits should not impair the trading while improving market integrity.

49. 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

50. 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.

51. ESMA considers these position limits to have been set in accordance with the above mentioned objectives and fully take into account that the liquidity profile of tin is smaller (considerably in some cases) than others in its asset class. Additionally tin has the shortest term structure of all liquid instruments subject to bespoke position limits, which is reflected in the reduced ratio of spot month to other month limits. Accounting for this, and the market profile, ESMA considers these limits suitable for the market conditions within which they will be active.

52. 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 an orderly market and orderly settlement, while ensuring that the development of commercial activities in the underlying tin market and the liquidity of the LME Tin futures and options are not hampered.

VI. Conclusion

53. 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. In addition, theother months' position limit complies 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