

EUROPEAN COMMISSION

Directorate-General for Financial Stability, Financial Services and Capital Markets Union

Director General

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Mr Steven Maijoor

Chairman

European Securities and Markets

Authority - ESMA

103, rue de Grenelle

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Dear Mr Maijoor, *Dear Steven,*

On 28 September 2015, ESMA submitted to the Commission the draft regulatory technical standard (draft RTS) on the application of position limits to commodity derivatives pursuant to Article 57(3) and (12) of Directive 2014/65/EU (MIFID II).

ESMA's draft RTS provides the methodology for the calculation of position limits with the aim of establishing a harmonised position limit regime for derivatives traded on trading venues and their economically equivalent OTC (EOTC) contracts.

The draft RTS lays down how competent authorities should apply the seven factors of Article 57(3) when establishing the spot month position limit and the other months' position limit for physically and cash settled contracts. The draft RTS also specifies how aggregation of positions within a group should be calculated, and what positions may qualify as reducing risk or when a firm may use a hedging exemption. Finally the draft RTS further specifies what constitutes an EOTC contracts for the purposes of applying position limits.

ESMA's draft RTS proposes a methodology whereby spot month limits can vary between 5 and 35% of the deliverable supply underpinning the commodity derivative. The other months' limit is to be set between 5% and 35% of the open interest in that commodity derivative. Furthermore, ESMA's draft RTS defines EOTC as needing to have contractual specifications that are identical to the contract traded on a venue.

On behalf of Commissioner Hill, I would like to inform you that DG FISMA intends to recommend that the Commission endorses the standard on position limits once certain amendments are made. These amendments also take into account concerns raised by the European Parliament in this area.

Overall, we are supportive of general approach that ESMA taken to this standard. However, DG FISMA considers that changes are necessary to meet the objective of the position limit regime as set out in Article 57(1) and recitals (125) and (127). Such an approach is consistent with some of the concerns raised by the European Parliament's ECON Committee regarding this standard.

In particular, DG FISMA is of the view that the methodology currently proposed in the draft RTS needs to take greater account of the specificities of each type of underlying commodity. Such differentiation is necessary to take into account that some commodity derivatives have very few participants whilst others are very liquid and to ensure that the proposed rules to meet their objectives of preventing market abuse, supporting orderly pricing and settlement conditions and promoting the integrity of the market.

The choice of open interest as a parameter to calculate the other months' position limits may not always be consistent with the aim of establishing a harmonised position limit regime. In particular, linking other months' limits to open interest would automatically yield higher limits when trading in the commodity derivative, and hence open interest, increases.

The narrow definition of EEOTC proposed could allow for easy circumvention of the regime using OTC contracts which would have similar economic exposures by simply changing a minor parameter of the exchange traded contract. This result hinders the objective pursued by the position limits' mechanism devised in Article 57 with respect to commodity derivatives.

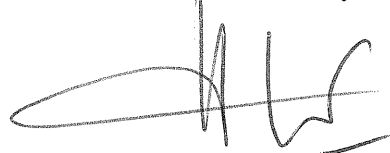
DG FISMA considers that, in order for the draft RTS submitted by ESMA to take full account of the objective of, and the mandate contained in, Article 57 of Directive 2014/65/EU, the following amendments are required:

- Sensitivity to different types of underlying commodities: Certain agricultural commodities should attract lower limits for both the spot and other months' limits because of their high volatility. ESMA should consider whether a lower baseline for these contracts is appropriate or whether lowering the minimal limit range would be more suitable. In parallel, ESMA should consider whether contracts with few market participants, or with low levels of liquidity, should benefit from higher maximum limit ranges.
- Other month limits: The RTS should be adjusted so that other month's limits are not skewed by the choice of open interest as a parameter for setting the limits. The RTS should adjust the other months' limits where there is a significant discrepancy between open interest and deliverable supply. When the open interest is significantly higher than the deliverable supply, the limits should be set lower; conversely when open interest is much smaller than deliverable supply, a higher limit should apply.
- Economically Equivalent OTC (EEOTC) Contracts: The definition of EEOTC contracts should be altered so that contracts which yield similar economic exposure for position holders whilst not necessarily identical in contractual terms are considered in scope of the limit regime. In particular ESMA should consider whether variations in lot sizes, delivery dates, locations or other terms change the economic exposure of the position.

I would like to inform you that DG FISMA will recommend that the Commission endorses the draft regulatory technical standard on the application of position limits to commodity derivatives once the once the above mentioned concerns are adequately taken into account and the necessary modifications are made.

I am very grateful for the work that has been undertaken by ESMA and its members to deliver the MiFID II level II package of measures. This is a substantial package that has been delivered professionally and to a high standard. The standards that have been submitted, if endorsed by the co-legislators, will contribute to better functioning markets in the EU with a high level of investor protection.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'O. Guersent', with a large, sweeping initial 'O'.

Olivier Guersent