Questions and Answers

On MiFID II and MiFIR commodity derivatives topics

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European Securities and Markets Authority

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Table of Contents

Acronyms and definitions used

CCP	Central Counterparty
EEOTC	Economically Equivalent OTC contracts
EMIR	European Market Infrastructure Regulation – Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories
ESMA	The European Markets and Securities Authority
ETC	Exchange Traded Commodities
ETF	Exchange Traded Fund
ITS 4	Commission implementing regulation (EU) 2017/1093 of 20 June 2017 laying down implementing technical standards with regard to the format of position reports by investment firms and market operators
LNG	Liquefied Natural Gas
MiFID I	Markets in Financial Instruments Directive – Directive 2004/39/EC of the European Parliament and of the Council
MiFID II	Markets in Financial Instruments Directive (recast) – Directive 2014/65/EU of the European Parliament and of the Council
MiFIR	Markets in Financial Instruments Regulation – Regulation 600/2014 of the European Parliament and of the Council
MTF	Multilateral Trading Facility
NCA	National Competent Authority
NFE	Non-Financial Entity
OTF	Organised Trading Facility
REMIT	Regulation on Wholesale Energy Market Integrity and Transparency – Regulation (EU) No 1227/2011 of the European Parliament and of the Council

RTS 2	Commission Delegated Regulation (EU) 2017/583 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives
RTS 20	Commission Delegated Regulation (EU) 2017/592 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 criteria to establish when an activity is considered to be ancillary to the main business
RTS 21	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 to commodity derivatives

Table of questions

		Topic of the Question	Level 1/Level 2 issue	Last Update
	1	Are position limits applicable only at the end of each trading day or also throughout the trading day?	Art. 57 of MiFID II	19/12/2016
	2	What is definition of lot for energy products?	Art. 9 of RTS 21	31/05/2017
	3	What is a lot in the case of Economically Equivalent OTC contracts (EEOTC)?	Art 9 of RTS 21	19/12/2016
	4	Should positions with different maturities for other month's limits be netted?	Art. 3(4) of RTS 21	19/12/2016
	5	How should non-EU entities with positions above the thresholds be treated? Do they have access to exemptions, and if so, when and how do they apply to the relevant NCA?	Art 57 of MiFID II; RTS 21	19/12/2016
	6	How do limits apply to long and short positions?	Art. 3 of RTS 21	19/12/2016
	7	Are securitized derivatives considered to be commodity derivatives under MIFID II? How does ESMA differentiate between ETCs and securitized derivatives?	Art. 4(1)(44)(c) and Annex I of MiFID II; Art. 2(1)(30) of MiFIR.	19/12/2016
	8	Are the net positions held by clearing members usable for the purposes of determining the positions of their clients for the application of position limits under Article 57?	Art. 57 of MiFID II; Art 12 of RTS 21	19/12/2016
	9	Will there be a different position limit for options and futures? If so, how should options be converted into futures for the application of position limits?	Art. 3 of RTS 21	19/12/2016

	10	How is the position limits regime applied to the various underlyings listed in Annex I, Section C(10) of MIFID II?	Annex I, Section C(10) of MIFID II	29/03/2017
	11	Can a hedge exemption be netted against positions in derivatives which are not objectively measurable as reducing risks directly related to that person's commercial activity?	Art. 8 of RTS 21	29/03/2017
	12	What is the meaning of the 'single fungible pool of open interest' in Art 5.1(b) of RTS 21? Does it refer only to those commodity derivatives cleared in the same central counterparty?	Art 5(1)(b) of RTS 21	29/03/2017
	13	How should contracts that have a high variability of open interest during the year be treated (i.e. minimum open interest is below 10,000 lots but maximum above it)?	Art. 15 of RTS 21	29/03/2017
	14	Is it necessary for a Non-Financial Entity (NFE) to apply to the relevant NCA of a trading venue for a position limit exemption in all contracts in which that NFE holds positions?	Art 57 of MiFID II; RTS 21	07/07/2017
	1	Do all legal entities that deal in commodity derivatives within a financial group need to be individually authorised as investment firms?	Art. 2(1)(j) of MiFID II	19/12/2016
	2	Does trading activity in C6 contracts which takes place on OTFs after 3 January 2018 need to be counted towards the	MiFID II Annex I Section C6 ; Art. 6 of Commission Delegated Regulation (EU)	19/12/2016

		ancillary thresholds prior to that date?	2017/565 of 25 April 2016; Article 2(4) of REMIT	
Ancillary activity	3	Since elements of the ancillary activity tests are to be calculated on a group level, is only the parent undertaking obliged to notify its NCA for the whole group or do the subsidiary undertakings also have to notify their local NCA?	Art. 2(1)(j) of MiFID II	19/12/2016
	4	Who has to notify annually the relevant competent authority that they make use of the ancillary activity exemption?	Art. 2(1)(j) of MIFID II	31/05/2017
	5	To which competent authority should a person provide notification that it makes use of the ancillary activity exemption?	Art. 2(1)(j) of MIFID II	31/05/2017
	6	By when does a firm that wants to make use of the ancillary activity exemption need to notify its competent authority?	Art. 2(1)(j) of MIFID II	31/05/2017
	7	When does a firm that can no longer make use of the ancillary activity exemption need to apply for a license?	Art. 2(1)(j) of MIFID II	31/05/2017
	8	What are the criteria that liquidity provision contracts need to meet in order to qualify for the privileged transactions exemption?	Art. 2(4) of MIFID II	31/05/2017
	9	Should the capital employed test be calculated only on the same positions as included in the market size test or for all commodity derivatives traded in the group?	Art. 3(1)(b) RTS 20	31/05/2017
	10	Should the capital test be calculated using consolidated accounts? Should firms use capital on a worldwide basis or	Art. 3(9) of RTS 20	04/10/2017

		just capital employed within the EU?		
	11	How should various underlyings falling under the C(10) category be treated for the purpose of ancillary activity calculations?	RTS 20	04/10/2017
	1	Do positions held by an investment firm on behalf of their clients add to the investment firm's own positions?	Article 58 of MiFID II	07/07/2017
	2	How should investment firms report the positions in commodity derivatives of persons who receive investment or ancillary services from a non-investment firm that is an "end client" of the investment firm?	Article 58 of MiFID II	07/07/2017
	3	Who should submit position reports under Article 58(2) MiFID II?	Article 58 of MiFID II	07/07/2017
	4	Should investment firms include positions traded on a trading venue and economically equivalent OTC contracts in position reports under Article 58(2) MiFID II?	Article 58 of MiFID II	07/07/2017
	5	Does the requirement for trading venues to make public weekly aggregate position reports and to communicate that report to the competent authority and to ESMA apply to securitised derivatives?	Article 58(1)(a) of MiFID II	07/07/2017
	6	At what level should Asset Managers aggregate positions? Is this to be done at group level or a lower level (e.g. fund/legal entity identifier etc.)?	Article 58 of MiFID II	07/07/2017
	7	Which MIC should be used by trading venues for position reporting?	Article 58 of MiFID II	07/07/2017

	8	By when do positions have to be reported under Articles 58(1)(b) and 58(2) of MIFID II?	Article 58 of MiFID II	07/07/2017
	9	Does the requirement under Article 58(1)(b) and (2) of MiFID II to submit daily position reports to the NCA apply to securitised derivatives with a total number of securities in issue not exceeding 2.5 million?	Article 58 of MiFID II	07/07/2017
	10	How does ESMA propose to address the breaches of applicable non-EU laws and regulations regarding data protection and bank secrecy which may potentially arise from the reporting of client and end client positions?	Article 58 of MiFID II	07/07/2017
Position management controls	1	Are position management controls required to play a role in the application of position limits applied by NCAs according to Article 57(1) MiFID II?	Art. 57 of MIFID II	04/10/2017
Third country issues	1	Should economically equivalent contracts traded on a third-country venue be considered EEOTC for position limit and position reporting purposes under MiFID II?	Art. 58(2) of MIFID II	31/05/2017

1 Introduction

Background

The final legislative texts of Directive 2014/65/EU[1] (MiFID II) and Regulation (EU) No 600/2014[2] (MiFIR) were approved by the European Parliament on 15 April 2014 and by the European Council on 13 May 2014. The two texts were published in the Official Journal on 12 June 2014 and entered into force on the twentieth day following this publication – i.e. 2 July 2014.

Many of the obligations under MiFID II and MiFIR were further specified in the Commission Delegated Directive[3] and two Commission Delegated Regulations[4] [5], as well as regulatory and implementing technical standards developed by the European Securities and Markets Authority (ESMA).

MiFID II and MiFIR, together with the Commission delegated acts as well as regulatory and implementing technical standards will be applicable from 3 January 2018.

Purpose

The purpose of this document is to promote common supervisory approaches and practices in the application of MiFID II/ MiFIR in relation to the position limits, position reporting and ancillary activity provisions and other aspects of the commodity derivatives regime in MiFID II. It provides responses to questions posed by the general public, market participants and competent authorities in relation to the practical application of MiFID II/MiFIR.

The content of this document is aimed at competent authorities and firms by providing clarity on the application of the MiFID II and MiFIR requirements.

The content of this document is not exhaustive and it does not constitute new policy.

[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.
[2] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) N0 648/2012.
[3] Commission Delegated Directive (EU) 2017/593 of of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.
[4] Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive..
[5] Commission Delegated Regulation(EU) 2017/567of 18 May 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to definitions, transparency, portfolio compression and supervisory measures on product intervention and positions..

Status

The Q&A mechanism is a practical convergence tool used to promote common supervisory approaches and practices under Article 29(2) of the ESMA Regulation.[6]

Due to the nature of Q&As, formal consultation on the draft answers is considered unnecessary. However, even if they are not formally consulted on, ESMA may discuss them with representatives of ESMA's Securities and Markets Stakeholder Group, the relevant Standing Committees' Consultative Working Group or, where specific expertise is needed, with other external parties.

ESMA will periodically review these questions and answers to identify if, in a certain area, there is a need to convert some of the material into ESMA Guidelines and recommendations. In such cases, the procedures foreseen under Article 16 of the ESMA Regulation would be followed.

The Q&As in this document cover only activities of EU investment firms in the EU, unless specifically mentioned otherwise. Third country related issues, and in particular the treatment of non-EU branches of EU investment firms, will be addressed in a dedicated third country section.

Questions and answers

This document is intended to be continually edited and updated as and when new questions are received. The date on which each section was last amended is included for ease of reference.

[6] Regulation (EU) No 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 Regulation, 15.12.2010, L331/84.

2 Position limits [Last update: 07/07/2017]

Question 1 [Last update: 19/12/2016]

Are position limits applicable only at the end of each trading day or also throughout the trading day?

Answer 1

Position limits are applicable at all times. This is particularly relevant when a commodity derivative is traded OTC outside the normal trading hours of a trading venue.

Question 2 [Last update: 31/05/2017]

What is the definition of lot for energy products?

Answer 2

In derivatives markets where the underlying asset is electricity, natural gas (gas) or liquefied natural gas (LNG) and there is no concept of a standardised lot as a unit of trading the following approach should be used:

Delivery period: the period over which the contract is delivered (physically or by cash settlement vs spot prices). These periods may be annual (calendar), quarterly, monthly, weekly (whole week, labour week and weekend) or daily. For gas and LNG derivative contracts the units of time for delivery are typically days.

Unit of registration: Generally, it is 1 Megawatt MW, but there are ISINs whose unit of registration is a multiple or a proportion of MW (e.g. 0.1 MW)

Product type: For most power derivatives the underlying is delivered as a fixed quantity per hour during a defined number of hours (“relevant hours”) in the relevant days of the delivery period. There are two main product types for power derivatives:

- **Base Load**: Relevant hours are 24 per day, as the underlying asset is delivered from the first hour of the day (0:00 to 00:59 hours) until the last hour of the day (23:00 to 23:59 hours) of relevant days included in the delivery period.

- **Peak Load**: Relevant hours are different in different jurisdictions and are usually specified as part of the day (for example, 12 hours where an underlying asset is delivered from the ninth hour of the day (08:00:00 to 08:59:00 hours) until the twentieth hour of the day (19:00 to 19:59 hours) of every Monday, Tuesday, Wednesday, Thursday and Friday (relevant days) included in the delivery period).

Nominal/multiplier of a contract: the implicit multiplication of the deliverable underlying in the contract. For power contracts, it is in MWh.

For **Power derivatives**

Nominal = Unit of registration * number of relevant days (in delivery period) * relevant hours (per day)

For **Gas and LNG derivatives**

Nominal = Unit of registration * number of relevant days (in delivery period)

Where a lot is not defined for energy contracts, according to Article 9 of RTS 21, a lot should be the minimum quantity tradable of that commodity derivative, calculated as nominal * minimum number of contracts to be included in a trade.

For gas and LNG, a lot will be 1 MWh, except for gas derivatives where the number of contracts traded as a unit is above this size.

If the minimum amount tradable were one daily contract of 1 MW, for example, the lot size would be 24 MWh for typical base load contracts or 12 MWh for peak load contracts, as the typical timeframe of peak hours corresponds to 12 per relevant day. Whereas, if the minimum amount tradable is not a daily, but a monthly contract, a lot corresponds to the MWh that are to be delivered according to that contract (e.g. 720 MWh for base load contracts, considering a month composed of 30 days).

Question 3 [Last update: 19/12/2016]

What is a lot in the case of Economically Equivalent OTC contracts (EEOTC)?

Answer 3

A significant number of OTC contracts are specified by reference to a quantity of the underlying commodity and not the standardised lot sizes of an exchange-traded derivative. Where an OTC contract is not defined in standardised lots the size of the contract should be calculated as a multiple of the standard unit of trading used by the trading venue for the commodity derivative to which the OTC contract is equivalent.

Question 4 [Last update: 19/12/2016]

Should positions with different maturities for other months' limits be netted?

Answer 4

Yes. Persons must determine their net position for each commodity derivative for the other months' limit, as indicated in Article 3(4) of RTS 21.

They should sum (or net, as appropriate) all individual positions across the curve excluding those positions in the spot month for that commodity derivative.

Question 5 [Last update: 19/12/2016]

How should non-EU entities with positions above the limits be treated? Do they have access to exemptions, and if so, when and how do they apply to the relevant NCA?

Answer 5

A non-financial entity from outside the EU (European Union) may apply for an exemption in the same manner as an EU firm would. The rules and procedures are laid down in RTS 21.

Question 6 [Last update: 19/12/2016]

How do limits apply to long and short positions?

Answer 6

Position limits apply to net positions regardless of whether the net position is long or short. When calculating their positions, a person needs to aggregate their long and short holdings in spot contracts towards the spot month limit. They separately need to aggregate all their long and short positions for all other months towards the other months' limit.

Question 7 [Last update: 19/12/2016]

Are securitised derivatives considered to be commodity derivatives under MiFID II? How does ESMA differentiate between ETCs and securitised derivatives?

Answer 7

"Securitised derivatives" are transferable securities whose value is based upon underlying assets. However, neither MiFID I (incl. level 2 thereof), nor MiFID II/MiFIR contain a specific definition of these instruments.

Where the underlying asset of securitised derivatives is one or more commodities, these instruments are caught by the definition of "transferable securities" in Article 4(1)(44)(c) of MIFID II and are commodity derivatives under Article 2(1)(30) of MiFIR.

Exchange traded commodities (ETCs) are debt instruments which are within the scope of Article 4(1)(44)(b) of MiFID II and are classified as such in RTS 2. Therefore, they are outside the definition of commodity derivatives in Article 2(1)(30) of MiFIR and the position limits regime does not apply to them.

ESMA is aware that market practices in differentiating between ETCs and securitised derivatives are neither clear nor uniform and presents the following guidance to allow for a correct classification of instruments in practice.

In RTS 2 ETCs are described as debt instruments issued against a direct investment by the issuer in commodities or commodity derivative contracts. The price of an ETC is directly or indirectly linked to the performance of the underlying. An ETC passively tracks the performance of the commodity or the commodity indices to which it refers.

In addition, ESMA considers that ETCs typically have the following features:

- a primary market exists which is accessible only to authorised market participants permitting the creation and redemption of securities on a daily basis at the price set by the issuer;
- they are not UCITS and therefore unlike an ETF can have an exposure profile not in compliance with the UCITS diversification requirements;
- they are traded on- and off-venue in significant volumes;
- the price is aligned, or multiplied by a fixed leverage of the price of the underlying commodity;
- a management fee is charged by the issuer;
- they may be issued by non-banking institutions;
- they do not have an expiry date;
- they may have a strict regime of capital segregation, usually through the use of special purpose vehicles;
- they are often aimed at professional investors.

In comparison, the term 'securitised derivatives' describes a much wider set of financial instruments that can have a large variety of features among them the following typical features:

- they can have commodities as underlying but also many financial instruments or they can be linked to strategies, indices or baskets of instruments;

- they can passively track the performance of the underlying but they can typically also apply leverage, can have an option structure or also have a lower risk profile than the underlying by, for example, offering capital protection;

- they are traded on venue or OTC by the issuer directly or via intermediaries;

- the issuers' costs and compensation are factored into their price;

- they have an expiration date;

- they provide an issuer credit risk exposure;

- they are often aimed at retail clients.

Question 8 [Last update: 19/12/2016]

Are the net positions held by clearing members usable for the purposes of determining the positions of their clients for the application of position limits under Article 57?

Answer 8

No. Central counterparties determine net positions at the level of their clearing members, which usually encompass the long and short position of many different clients unless held in individually segregated accounts. A CCP may also see positions only for those contracts for which it provides a central counterparty service and not the EEOTC positions or any held at a CCP subject to interoperability. Position limits apply at the level of the individual person, and net positions held at clearing level must therefore be disaggregated.

Question 9 [Last update: 19/12/2016]

Will there be a different position limit for options and futures? If so, how should options be converted into futures for the application of position limits?

Answer 9

No, separate limits will not be set for futures and options on the same commodity derivative.

Futures and options are fungible in terms of their economic effect at expiry if an option expires in the money with the respective future expiring at the same time. During the life of an option con-tract, the probability it will expire in the money is reflected in its delta value, with an option that is more likely to be in the money having a higher delta value.

Option positions should therefore be converted into positions in their respective future contracts positions on the basis of the current delta to arrive at a delta equivalent futures position. Long delta equivalent positions on calls and short delta equivalent positions on puts should be added to long positions on futures. Short delta equivalent positions on calls and long delta equivalent positions on puts should be added to short positions on futures.

If available, position holders should use the delta value published by the trading venue or the CCP to report their positions in options.

In the absence of a published delta value, position holders may use their own calculation. Position holders should be able to demonstrate, on demand, to the National Competent Authority responsible for the application of the position limit that their calculations correctly reflect the value of the option.

The open interest of futures should be used for both futures and options on the same underlying.

Question 10 [Last update: 29/03/2017]

How is the position limits regime applied to the various underlyings listed in Annex I, Section C(10) of MIFID II?

Answer 10

Section C(10) of Annex I of MIFID II covers a number of different types of commodity derivatives. For these instruments the following approaches should be taken:

Position limits should be applied to **freight rate** derivatives (wet and dry freight) based on the open interest both in the spot month and in the other months.

Position limits should be applied to derivative contracts relating to **indices** if the underlying index is materially based on commodity underlyings as defined in Article 2 No. 6 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016. ESMA considers that the underlying index derivative is materially based on commodities if such commodities have a weighting of more than 50% in the composition of the underlying index. The spot and the other months' limits should be based on open interest only, in accordance with Article 13(1) of RTS 21, as no single measurable deliverable supply can be determined for the commodities contained within the index.

A commodity derivative contract in the legal form of a **"spread" or "diff"** contract is a contract that is cash-settled and whose value is determined by the difference between two reference commodities which may vary in type, grade, location, time of delivery, or other features. Whilst having multiple commodity values underlying it, the commodity derivative is available on a trading venue as a single tradable financial instrument. A spread contract is different to a spread trading strategy, when two or more commodity derivative contracts may be traded together in order to achieve a certain economic effect. Such a strategy may be executed by a single action in a venue's trading systems, but it remains composed of separate and legally distinct commodity derivatives which are executed as trades simultaneously.

As a spread contract has no single commodity at a specific place or time as the underlying, it is not possible to link it to a single physical deliverable supply against a contractual obligation to physically settle the trade. It is for this reason all spread contracts are cash-settled and not physically settled.

Therefore, spread contracts should be treated for the application of the ESMA methodology in the same manner as C10 commodity derivatives which do not have a physical underlying, such as weather derivatives. The open interest figure for the commodity derivative itself should be used as the baseline for both the Spot Month limit and the Other Months' limit

For other derivatives listed in Section C10 of Annex I of MiFID II and in Article 8 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016, ESMA is not expecting the setting of any position limits as the underlyings of such derivatives are not considered to be commodities as defined in Article 2 No. 6 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016.

Question 11 [Last update: 29/03/2017]

Can a hedge exemption be netted against positions in derivatives which are not objectively measurable as reducing risks directly related to that person's commercial activity?

Answer 11

No. Once an exemption has been granted and positions are approved as risk-reducing in accordance with Article 8 of RTS 21, those positions fall outside the position limit regime. Otherwise, the benefit of a risk-reducing position would be double-counted, by first being excluded from the limit and then being used to offset a speculative exposure.

Question 12 [Last update: 29/03/2017]

What is the meaning of the 'single fungible pool of open interest' in Art 5.1(b) of RTS 21? Does it refer only to those commodity derivatives cleared in the same central counterparty?

Answer 12

Commodity derivatives with a single fungible pool of open interest would include those cleared by the same central counterparty (CCP) and those in interoperable CCPs which may be closed out against each other. It would also include other commodity derivatives with delivery obligations which are fungible and can be closed out against each other (for example, through the operational netting provided by a transmission system operator).

Question 13 **[Last update: 29/03/2017]**

How should contracts that have a high variability of open interest during the year be treated (i.e. minimum open interest is below 10,000 lots but maximum above it)?

Answer 13

Article 15 of RTS 21 states that new and illiquid contracts for which the total combined open interest in spot and other months' contracts does not exceed 10,000 lots for a consecutive three-month period are assigned a position limit of 2,500 lots. Therefore, any contract with a high variability would have to exceed the threshold of 10,000 lots of open interest on a daily basis based on end-of-day figures for three consecutive months before an individualised position limit has to be set for that contract.

Question 14 **[Last update: 07/07/2017]**

Is it necessary for a Non-Financial Entity (NFE) to apply to the relevant NCA of a trading venue for a position limit exemption in all contracts in which that NFE holds positions?

Answer 14

No. It is necessary only for an NFE to apply for an exemption when it expects that one is necessary to permit it to hold a position that is risk-reducing for its commercial activities which would be in excess of the position limit for that commodity derivative which has been set by the NCA.

There is no requirement under MIFID II to apply for a position limit exemption if an NFE does not expect to need one for its normal level of activities.

3 Ancillary activity [Last update: 04/10/2017]

Question 1 **[Last update: 19/12/2016]**

Do all legal entities that deal in commodity derivatives within a financial group need to be individually authorised as investment firms?

Answer 1

Yes. Under Article 2(1)(j), the exemption for trading in commodity derivatives only applies when the main business of the group is considered on an overall basis not to be the provision of investment services within the meaning of this Directive or banking activities under Directive 2013/36/EU.

Therefore, all entities within a group which cannot be considered as a non-financial group are required to obtain authorisation as an investment firm under MiFID II if they wish to trade commodity derivatives.

Question 2 [Last update: 19/12/2016]

Does trading activity in C6 contracts which takes place on OTFs after 3 January 2018 need to be counted towards the ancillary thresholds prior to that date?

Answer 2

We differentiate between wholesale energy products categorised as C6 within the REMIT scope (derivatives with electricity and natural gas as underlying traded on an OTF that must be physically settled), C6 energy derivatives contracts (those with coal or oil as underlying traded on an OTF that must be physically settled) and the rest of C6 instruments.

Financial instruments under MiFID I which will also be financial instruments within C6 under MiFID II should count towards the trading activity and assessed against the ancillary thresholds.

C6 with coal or oil as underlying and the rest of C6 instruments count throughout the calculation period to determine market size, as OTC instruments until January 3, 2018 and as OTF on-venue instruments after that. For C6 instruments with coal or oil as underlying traded on OTFs this assessment is based on them only being exempted from certain EMIR obligations for a transitional period while they are being classified as financial instruments throughout the period. The same applies to the computation of positions by non-financial corporates.

Question 3 [Last update: 19/12/2016]

Since elements of the ancillary activity tests are to be calculated on a group level, is only the parent undertaking obliged to notify its NCA for the whole group or do the subsidiary undertakings also have to notify their local NCA?

Answer 3

The ancillary exemption applies to persons. Notification to the relevant NCA for that person is a condition for using the exemption. Therefore, any person that is party to a commodity derivative will need to notify its relevant NCA. This also applies to persons who are part of a group. It is not possible for a group to apply for an exemption on behalf of all the entities that the group contains.

Question 4 **[Last update: 31/05/2017]**

Who has to notify annually the relevant competent authority that they make use of the ancillary activity exemption?

Answer 4

In general, any (natural or legal) person that deals on own account or provides investment services in commodity derivatives as a regular occupation or business on a professional basis pursuant to Article 5 of MiFID II has to be authorised as an investment firm under MiFID II. However, if the person meets the criteria for activities considered to be ancillary to the main business pursuant to Article 2(1)(j) and the provisions in RTS 20 and makes use of the ancillary activity exemption, then it has to notify annually the relevant competent authority that they make use of this exemption.

Question 5 **[Last update: 31/05/2017]**

To which competent authority should a person provide notification that it makes use of the ancillary activity exemption?

Answer 5

The relevant competent authority will be the national competent authority to which the person would need to apply for authorisation if it were unable to make use of the ancillary activity exemption.

Question 6 **[Last update: 31/05/2017]**

By when does a firm that wants to make use of the ancillary activity exemption need to notify its competent authority?

Answer 6

Article 2(1)(j) of MiFID II exempts persons who deal in commodity derivatives on an ancillary basis under a number of conditions. One of these conditions is that they notify annually the relevant competent authority that they make use of this exemption. The notification needs to have been made for a firm to be able to rely on it.

The first of such notifications must be made by January 3rd of 2018. For 2019 and subsequent years, the notification needs to be made by April 1st of each year. Any firm that has not applied for authorisation has to notify.

Question 7 [Last update: 31/05/2017]

When does a firm that can no longer make use of the ancillary activity exemption need to apply for a license?

Answer 7

When a person's trading activity increases to such an extent that it can no longer be considered to be ancillary to its main business under Article 2(1)(j), the firm must apply to the competent authority for a license.

Firms may not be certain whether they will be able to benefit from the exemption until the data on market size becomes available. Those who have reasonable grounds for considering they will be able to benefit from the ancillary activity exemption should notify. Where subsequently the market data indicates that this is not the case, the firm would be expected to apply for authorisation as soon as reasonably practicable.

Question 8 [Last update: 31/05/2017]

What are the criteria that liquidity provision contracts need to meet in order to qualify for the privileged transactions exemption under Article 2(4) of MiFID II?

Answer 8

Article 2(4) fifth paragraph, letter (c) of MiFID II permits a number of transaction types to be classified as "privileged transactions" and thus to be set aside for the purposes of the ancillary activity calculations. Those transaction types include "transactions in commodity derivatives and emission allowances entered into to fulfil obligations to provide liquidity on a trading venue, where such obligations are required by regulatory authorities in accordance with Union law or with national laws, regulations and administrative provisions, or by trading venues". Therefore, Article 2(4)(c) of MiFID II establishes two alternatives of liquidity provision programmes that can be exempt from the ancillary activity calculations, one being based on requirements by regulatory authorities and the other based on requirements imposed by trading venues. Under both alternatives it is only the transactions carried out under the liquidity programme that are exempt but not the liquidity provider as a person.

When elaborating the Level 2 rules, ESMA offered one example of the circumstances in which transactions undertaken in order to fulfil liquidity obligations would be privileged, i.e. the market making requirements established by the UK energy regulator, OFGEM, which oblige large electricity suppliers to post the prices at which they buy and sell wholesale electricity on power trading platforms up to two years in advance and to trade at those prices. This is an example of an obligation required by a regulatory authority in line with applicable national rules which satisfies the conditions imposed by the first alternative described in Article 2(4)(c) of MiFID II.

Article 2(4)(c) of MiFID II uses the term "obligations to provide liquidity" as opposed to the related term market maker which is used in Article 2(1)(j)(i) of MiFID II to determine the scope of the ancillary activity exemption and which is defined in Article 4(1)(7) of MiFID II.

As a consequence, a liquidity provider under Article 2(4)(c) of MiFID II in addition to providing liquidity on a continuous basis and being willing to deal on own account against its proprietary capital has to be under genuine obligations to carry out transactions. Such obligations have to be specified in advance by the trading venue and have to be the subject of an enforceable agreement between the trading venue and the liquidity provider. The obligations a trading venue requires liquidity providers to fulfil have to be transparent to other market participants and be applied in a non-discriminatory manner.

The obligations of any liquidity provider have to go clearly beyond the activities of any ordinary market participant providing liquidity in a more general sense by simply trading on the market. The obligations should contain elements such as or comparable to quoting requirements with a maximum spread, a minimum volume, a minimum quote duration and, depending on the trading model, a maximum response time to provide quotes and a minimum participation rate. Only transactions executed under these obligations should be considered as privileged transactions.

Question 9 **[Last update: 31/05/2017]**

Should the capital employed test be calculated only on the same positions as included in the market size test or for all commodity derivatives traded in the group?

Answer 9

Article 3(1) b) RTS 20[7] refers to the estimated capital employed for those activities referred to in Article 1 of RTS 20. According to Article 3(3) RTS 20 the size of the activities referred to in Article 1 shall be calculated by aggregating the size of the activities with respect to all of the asset classes referred to in Article 2(1). Accordingly, the numerator of the capital test is calculated on the basis of the same positions as included in the market size test as only those asset classes referred to in Article 2(1) shall be included.

Question 10 **[Last update: 04/10/2017]**

Should the capital test be calculated using consolidated accounts? Should firms use capital on a worldwide basis or just capital employed within the EU?

[7] Commission delegated regulation (EU) 2017/592 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 criteria to establish when an activity is considered to be ancillary to the main business

Answer 10

The capital test should be calculated using consolidated accounts. According to Article 3(9) of RTS 20, the capital employed for carrying out the main business of a group shall be the sum of the total assets of the group minus its short-term debt as recorded in the consolidated financial statements of the group at the end of the relevant annual calculation period.

Firms shall use capital employed on a worldwide basis when calculating the capital test.

Question 11 [Last update: 04/10/2017]

How should various underlyings falling under the C(10) category be treated for the purpose of ancillary activity calculations?

Answer 11

The various commodity derivative underlyings within the scope of the C(10) category shall be treated consistently across all provisions concerning commodity derivatives in the MiFID II/MiFIR framework. Therefore, all those commodity derivative contracts with underlyings that are subject to the position limit regime as specified in Position Limits **Error! Reference source not found.** should also be counting towards the ancillary activity test calculations. Other contracts within the C(10) scope should not be counted.

4 Position reporting [Last update: 07/07/2017]

Question 1 [Last update: 07/07/2017]

Do positions held by an investment firm on behalf of their clients add to the investment firm's own positions?

Answer 1

Article 57(1) explicitly introduces the possibility that positions are held on behalf of another entity for legal or operational reasons. In order to avoid double counting, such positions are only to be reported as the positions of the person on whose behalf they are held. They are not to be added to or netted against other positions held by the investment firm.

Question 2 [Last update: 07/07/2017]

How should investment firms report the positions in commodity derivatives of persons who receive investment or ancillary services from a non-investment firm that is an "end client" of the investment firm?

Answer 2

As position limits apply to "persons", all positions in commodity derivatives must be included in position reporting. Where an investment firm is reporting the positions of an end client that is not an investment firm and does not therefore have reporting obligations of its own under MIFID II, its report should cover both the end-client's own account positions and any positions that the end-client holds on behalf of third parties.

Investment firms reporting such positions will reduce the risk of their reports erroneously identifying a breach of the position limit by the end-client by reporting the position of the end client separately from positions held by that end-client on behalf of third parties.

Further, by reporting the positions held by the end-client on behalf of third party entities on an entity-by-entity basis the investment firm will further reduce the risks of its reports erroneously identifying positions which appear to give rise to breaches because they aggregate across unaffiliated entities.

Entity-by-entity reporting is therefore encouraged, though ESMA recognises that the investment firm may not be able to disaggregate end-client's positions, and there is no obligation on non-investment firms to provide disaggregated positions.

Every person holding a position in commodity derivative is subject to the position limits even if their positions are aggregated in the reporting process.

Question 3 [Last update: 07/07/2017]

Who should submit position reports under Article 58(2) of MiFID II?

Answer 3

Only investment firms trading in commodity derivatives or emission allowances or derivatives thereof outside a trading venue (economically equivalent OTC contracts) should submit position reports under Article 58(2) of MiFID II.

Question 4 [Last update: 07/07/2017]

Should investment firms include positions traded on a trading venue and economically equivalent OTC contracts in position reports under Article 58(2) of MiFID II?

Answer 4

Investment firms should only include economically equivalent OTC contracts in position reports under Article 58(2) MiFID II, as positions traded on trading venues are already reported under Article 58(1)(b) MiFID II.

Question 5 **[Last update: 07/07/2017]**

Does the requirement for trading venues to make public weekly aggregate position reports and to communicate that report to the competent authority and to ESMA apply to securitised derivatives?

Answer 5

The weekly aggregate position reports to be published by trading venues under Article 58(1)(a) of MiFID II aim at providing transparency to investors about the view of the market that certain categories of traders may be taking. As an example, if non-commercial traders are predominantly long in grain futures, this would be indicative of a view among professional investors that grain prices are going to go up.

Providing this type of transparency to investors appears useful and meaningful with regards to contracts for instance with large open interest that serve as a reference or benchmark for market participants.

In contrast, trading in European securitised derivatives is fragmented with well over 10,000 instruments in issue and liquidity per contract is often low. The potential publication of a multitude of weekly reports in securitised commodity derivatives on a per security level when position holder thresholds are exceeded would send out a confusing picture to investors rather than serve the envisaged purpose of market-wide transparency.

ESMA also notes that under Article 83 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016, the obligation for a trading venue to make public weekly aggregate position reports applies "when both of the following two thresholds are met:

- 20 open position holders exist in a given contract on a given trading venue; and
- the absolute amount of the gross long or short volume of total open interest, ex-pressed in the number of lots of the relevant commodity derivative, exceeds a level of four times the deliverable supply in the same commodity derivative, expressed in number of lots.

Where the commodity derivative does not have a physically deliverable underlying asset and for emission allowances and derivatives thereof, point (b) shall not apply."

While the condition of 20 position holders could be applied to securitised derivatives, the terminology of condition (b) referring to long or short volumes of open interest expressed in lots appears to be geared solely towards the contracts described in MiFID II, Annex I, Section C (5), (6), (7) and (10).

Based on the above, ESMA is of the view that Article 58(1)(a) of MiFID II and the Commission Delegated Regulation (EU) 2017/565 dealing with weekly position reports does not apply to securitised derivatives.

Question 6 [Last update: 07/07/2017]

At what level should Asset Managers aggregate positions? Is this to be done at group level or a lower level (e.g. fund/legal entity identifier etc.)?

Answer 6

Under Article 4 (2) of RTS 21, as an exception to the general rule on calculating positions for legal entities within a group, the parent undertaking of a collective investment undertaking (CIU), or of the management company of a collective investment scheme, should not aggregate the positions in commodity derivatives in any collective investment undertaking where it does not in any way influence the investment decisions in respect of opening, holding or closing those positions. In that case, positions are to be reported at CIU/LEI level. Alternatively, if the parent undertaking influences investment decisions by the collective investment undertaking or by the management company of a collective investment undertaking, it should aggregate the positions held in the relevant collective investment scheme(s).

The parent undertaking has to conduct a self-assessment exercise to determine whether it exercises any influence on investment decisions by the collective investment undertaking or by the management company of a collective investment undertaking, taking into account any relevant circumstances governing the relationship between the parent undertaking and the CIU or its management company.

Upon request, the parent undertaking should be in a position to explain to the relevant competent authority why it deems it does not exercise any influence on the decisions of the CIU or its management company.

Question 7 [Last update: 07/07/2017]

Which MIC should be used by trading venues for position reporting?

Answer 7

Venues should use the relevant ‘segment MIC’ under which a commodity derivative is traded. If a venue does not have a segment MIC, it should use its ‘operating MIC’.

Question 8 [Last update: 07/07/2017]

By when do positions have to be reported under Articles 58(1)(b) and 58(2) of MIFID II?

Answer 8

Trading venues and investment firms should report their positions to the respective NCA by 22:00 CET on T+1.

Question 9 [Last update: 07/07/2017]

Does the requirement under Article 58(1)(b) and (2) of MiFID II to submit daily position reports to the NCA apply to securitised derivatives with a total number of securities in issue not exceeding 2.5 million?

Answer 9

No. The NCAs do not need to require the submission of daily position reports of securitised derivatives with a total number of securities in issue not exceeding 2.5 million. The purpose of daily reporting is to monitor for potential breaches of position limits. To that end, Article 58(3) of MiFID II stipulates that daily position reporting shall enable monitoring of compliance with Article 57(1) of MiFID II. Accordingly, the reporting requirement has been set for situations in which reporting is necessary to enable monitoring. As a consequence, NCAs do not need to require daily reporting if the possibility of a breach of position limits can be ruled out from the outset.

These instruments would be illiquid contracts and benefit from the derogation pursuant to Article 15(1)(c) of RTS 21 with regard to regulatory technical standards for the application of position limits to commodity derivatives. For issues not exceeding 2.5 million securities it is per se not possible to breach position limits.

Trading venues that would otherwise be required to submit position reports of these securitised derivatives must confirm to the NCA that the total number of securities in issue does not exceed the 2.5 million threshold. The NCA assesses whether this condition is fulfilled. The reporting entity can rely on information provided by the CSD, the issuer, or another reliable source that ensures up-to-date knowledge on the current number of securities in issue. As soon as the threshold is exceeded, position reporting must be performed.

Question 10 [Last update: 07/07/2017]

How does ESMA propose to address the breaches of applicable non-EU laws and regulations regarding data protection and bank secrecy which may potentially arise from the reporting of client and end client positions?

Answer 10

Article 58(2) of MiFID II requires investment firms trading in commodity derivatives to provide to the relevant competent authority a complete breakdown of their positions as well as those of their clients and the clients of those clients until the end-client is reached. ITS 4 provides a template for such reporting. Position holders are to be identified in the same way as for transaction reporting purposes. Legal persons are identified by their LEI. For non-EU position holders that are natural persons, the identifier with the highest priority is the passport number, the second priority being a unique CONCAT code combining nationality, first name and surname of the position holder.

The requirement to identify clients and clients of clients until the end client in position reports cannot be waived. Therefore, where an investment firm would be dealing with or on behalf of clients or clients of clients that cannot be identified in position reporting because of legal, regulatory or contractual impediments, that investment firm would not be deemed compliant with its obligations under Article 58(2) of MiFID II.

5 Position management controls [Last update: 04/10/2017]

Question 1 [Last update: 04/10/2017]

Are position management controls required to play a role in the application of position limits applied by NCAs according to Article 57(1) MiFID II?

Answer 1

No. NCAs are responsible for the application of position limits established under Article 57(1). Recital (128) MiFID further specifies that the powers to require the reduction or termination of a position or to provide back liquidity should "mitigate the effects of a large or dominant position".

However, the controls listed in Article 57(8) are not exhaustive and shall not prevent trading venues from developing their own position limits as a mean to control positions held on commodity derivatives traded on their trading venues.

6 Third country issues [Last update: 31/05/2017]

Question 1 [Last update: 31/05/2017]

Should economically equivalent contracts traded on a third-country venue be considered EEOTC for position limit and position reporting purposes under MiFID II?

Answer 1

Whether or not positions held in commodity derivatives contracts traded on third-country venues that are economically equivalent (EE) to contracts traded on an EU trading venue, are to be considered as EETOC for position limit and position reporting purposes under Article 58(2) of MiFID II depends on the characteristics of that third-country trading venue, as set out in ESMA Opinion 70-154-165 of 31 May 2017.

Market participants holding positions on third country venue contracts, that may be considered EEOTC under Article 58(2) of MiFID II and Article 6 of 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 to commodity derivatives (RTS 21), or considering trading such contracts, should contact their CA and make them aware of those contracts. The CA will then get in touch with the third-country venue with a request for further information. Based on the information provided, ESMA will determine whether the third-country trading venue meets the criteria set out in the ESMA Opinion. If so, the respective third-country venue will be listed in an Annex to the Opinion.

Where a third-country trading venue appears in the annex to the Opinion, EE contracts traded on that venue will not be considered EEOTC for position limit and position reporting purposes. EE contracts traded on any other third-country trading venue that does not appear in the Annex to the Opinion will be considered EEOTC.

ESMA is aware that it is important for market participants to have legal certainty as soon as possible on the treatment of their transactions in EE contracts on third-country trading venues for position limit and reporting purposes. Whilst ESMA cannot commit to any set timeline for the assessment of the information received through NCAs, all notifications will be processed as expediently as possible.