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 (Text with EEA relevance)

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

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments[(1)], and in particular Article 57(3) and (12) thereof,

Whereas:

(1) In order to ensure a harmonised approach to applying position limits to commodity derivatives in the Union, a methodology should be specified for calculating those limits. The methodology should prevent regulatory arbitrage and promote consistency whilst providing competent authorities with sufficient flexibility to take into account the variations among different commodity derivatives markets and the markets in the underlying commodities. The methodology for calculating the limits should allow competent authorities to balance the objectives of setting limits at a level sufficiently low to prevent persons holding positions in those commodity derivatives from abusing or distorting the market against the objectives of supporting orderly pricing and settlement arrangements, developing new commodity derivatives and enabling commodity derivatives to continue to support the functioning of commercial activities in the underlying commodity market.

(2) In order to clearly identify a limited number of concepts stemming from Directive 2014/65/EU, as well as to specify technical terms necessary for this Regulation, a number of terms should be defined to ensure uniform application.

(3) Long and short positions in a commodity derivative of market participants should be netted off against each other to determine the effective size of a position a person controls at any point in time. The size of a position held through an option contract should be calculated on a delta equivalent basis. As this Regulation applies a different methodology to the calculation of position limits for spot and other months' contracts, such netting should be applied separately to the spot and other months' positions.

(4) Directive 2014/65/EU requires that any positions held by other persons on behalf of a person should be included in the calculation of that person's position limit and for position limits to be applied at both an entity level and at a group level and it is therefore necessary to aggregate positions at a group level. It is appropriate to only provide for aggregation at the group level if a parent undertaking can control the use of positions. Accordingly, parent undertakings should aggregate positions held by their subsidiaries with any positions that the parent entity holds directly, in addition to the subsidiaries aggregating their own positions. Such aggregation can lead to positions calculated at the level of the parent undertaking which are larger or, due to a netting of long and short positions held by different subsidiaries, lower than at individual subsidiary level. Positions should not be aggregated at the level of the parent undertaking if the positions are held by collective investment undertakings which hold those positions on behalf of their investors rather than on behalf of their parent undertakings in cases where the parent undertaking cannot control the use of those positions for its own benefit.

(5) The concept of the same commodity derivative should establish a demanding threshold to prevent persons from inappropriately netting positions across dissimilar commodity derivatives in order to circumvent and weaken the robustness of the position limit on the principal commodity derivative contract. This should not prevent competent authorities from setting similar position limits for similar commodity derivative contracts under the coordination of the European Securities and Markets Authority (ESMA). Commodity derivatives should only be considered as trading in significant volume on a trading venue if they exceed the liquidity threshold specified in this Regulation for a sufficient period of time.

(6) Where an over-the-counter (OTC) contract is valued on the same underlying commodity that is deliverable at the same location and with the same contractual conditions and if it is having a highly correlated economic outcome to a contract traded on a trading venue, it should be deemed economically equivalent regardless of small differences in the contractual specifications concerning the lot sizes and the date of delivery. Also differences in post trade risk management arrangements, such as clearing arrangements, should not be barriers to declaring such contracts as economically equivalent. In order to prevent inappropriate netting of potentially dominant positions traded on a trading venue by the use of bilateral arrangements in OTC contracts and to ensure an efficient operation of the position limits regime in practice it is necessary for commodity derivatives traded OTC to be considered economically equivalent to trading venue contracts only in limited circumstances. To deter avoidance of position limits and to enhance the integrity of the position limit regime it is necessary that a definition of an economically equivalent OTC contract is narrowly framed so that it does not permit a person to net an OTC position against multiple other positions or to exercise discretion in the choice of positions against which it is netted.

(7) In order to establish which positions in commodity derivatives are objectively measurable as reducing risks directly relating to commercial activity, certain criteria should be provided, including the use of the accounting definition of a hedging contract based on International Financial Reporting Standards (IFRS) rules. That accounting

definition should be also available to non-financial entities even though they do not apply IFRS rules at an entity level.

(8) Additionally, non-financial entities should be able to use risk management techniques to mitigate their overall risks arising from their commercial activity or that of their group, including risks arising from several geographic markets, several products, time horizons or entities ('macro or portfolio hedging'). When a non-financial entity uses macro or portfolio hedging, it may not be able to establish a one-to-one link between a specific position in a commodity derivative and a specific risk arising from the commercial activity that the commodity derivative is intended to hedge. A non-financial entity may also use a non-equivalent commodity derivative to hedge a specific risk arising from commercial activity where an identical commodity derivative is not available or where a more closely correlated commodity derivative does not have sufficient liquidity ('proxy hedging'). In such cases, risk management policies and systems should be able to prevent non-hedging transactions from being categorised as hedging and should be able to provide for a sufficiently disaggregate view of the hedging portfolio so that speculative components are identified and counted towards the position limits. Positions should not qualify as reducing risks related to commercial activity solely on the grounds that they have been included as part of a risk-reducing portfolio on an overall basis.

(9) A risk may evolve over time and, in order to adapt to the evolution of the risk, commodity derivatives initially executed for reducing risk related to commercial activity, may have to be offset through the use of additional commodity derivative contracts that close out those commodity derivative contracts that have become unrelated to the commercial risk. Additionally, the evolution of a risk that has been addressed by the entering into of a position in a commodity derivative for the purpose of reducing risk should not subsequently give rise to the re-evaluation of that position as not being a privileged transaction ab initio.

(10) Non-financial entities should be able to apply for the exemption in relation to hedging of commercial activities before entering into a position. The application should give the competent authority a clear and concise overview of the commercial activities of the non-financial entity in respect of an underlying commodity, the associated risks and how commodity derivatives are utilised to mitigate those risks. Position limits apply at all times and should the exemption ultimately not be granted by the competent authority, the non-financial entity should reduce any position in excess of a limit accordingly and may face supervisory measures in respect of a breach of a limit. Non-financial entities should re-assess their activities periodically to ensure that the continued application of the exemption is justified.

(11) The spot-month period, which is the time period immediately before delivery at expiry, is specific to each commodity derivative and may not correspond to exactly one month. Spot month contracts should therefore refer to the contract that is the next contract in that commodity derivative to mature. Restricting the positions a person may hold in the period during which delivery of the physical commodity is to be made limits the quantity of the underlying deliverable supply each person may make or take delivery of, thereby preventing the accumulation of dominant positions by individuals which may

enable them to squeeze the market through restricting access to the commodity. The standard baseline for the spot month position limit for both physically and cash settled commodity derivatives should therefore be computed as a percentage of the deliverable supply estimate. Competent authorities should be able to implement a schedule of decreasing position limits ranging from the point in time when a contract becomes a spot month contract until maturity in order to more precisely ensure that position limits are adequately set throughout the spot month period and to ensure orderly settlement.

(12) The other months' position limit is applied across all maturities other than the spot month. The standard baseline for the other months' position limits for both physically and cash settled commodity derivatives should be computed as a percentage of the total open interest. The distribution of positions across the other months' of a commodity contract is often concentrated in the months closest to maturity. Therefore total open interest provides a more appropriate baseline for setting position limits than using a figure averaged across all maturities.

(13) The standard baseline of 25 % of deliverable supply and of open interest has been set with reference to the experience of other markets and other jurisdictions. The baseline should be adjusted by competent authorities to enable it to be reduced by a maximum of 20 % (or 22,5 % in the case of some agricultural commodity derivatives) and to be increased by a maximum of 10 % (or 15 % in the case of less liquid commodity derivatives) should the characteristics of the market require it, such as an absence of market participants, in order to support the orderly settlement and functioning of the contract and its underlying market. Since any adjustment to the baseline figure applies only where, and for so long as, objective characteristics of the market require it, temporary adjustments to the baseline should be therefore possible. Competent authorities should ensure that an adjustment downwards of the baseline is effected whenever it is necessary to prevent dominant positions and to support orderly pricing in the commodity derivative and in the underlying commodity. The range reflects that Directive 2014/65/EU covers a wider range of commodity derivatives and markets than other markets and jurisdictions. The definition of commodity derivative under Article 2(1)(30) of Regulation (EU) No 600/2014 of the European Parliament and of the Council[(2)] is broad, comprising also securitised derivatives and cash settled derivatives which do not have a tangible underlying such as climatic variables. For securitised derivatives the concept of spot and other months' does not apply. For derivatives without a tangible underlying the deliverable supply cannot be used to establish a position limit. Therefore competent authorities should be able to enhance or adjust the methodologies to determine position limits for these commodity derivatives based on different parameters like number of securities issued or the use of open interest also for the spot month.

(14) Certain commodity derivatives, in particular for power and gas, provide that the underlying be delivered constantly over a specified period of time such as day, month or year. Moreover, certain contracts with longer delivery periods such as year or quarter may be automatically substituted by related contracts of shorter delivery periods such as quarter or month (cascading contracts). In these cases, a spot month position limit for the contract to be substituted prior to delivery would be inappropriate, as such limit

would not cover the expiry and physical delivery or cash settlement of the contract. To the extent that delivery periods of contracts for the same underlying overlap, a single position limit should apply to all the related contracts in order to properly take into account the positions across those contracts which may potentially be delivered. To facilitate this, related contracts should be measured in units of the underlying and aggregated and netted accordingly.

(15) For certain agricultural commodity derivatives, which have a material impact on consumer food prices, the methodology enables a competent authority to set a baseline and position limit beneath the minimum of the general range where it finds evidence of speculative activity impacting significantly on prices.

(16) The competent authority should assess whether the factors listed under paragraph 3 of Article 57 of Directive 2014/65/EU necessitate adjustment of the baseline in order to set the final level of the position limit. The assessment should take into account these factors as relevant for the particular commodity derivative in question. The methodologies should provide a direction of how to set the limit without taking away the ultimate decision on an appropriate position limit for a commodity derivative from the competent authority in order to prevent market abuse. The factors should give important indications to the competent authorities and also to ESMA to facilitate forming its opinions and ensuring an adequate alignment of position limits across the Union, including by assessing the impact of volatility on a case by case basis and as frequently as necessary to ensure position limits remain appropriate.

(17) Position limits should not create barriers to the development of new commodity derivatives and should not prevent less liquid sections of the commodity derivative markets from working adequately. Competent authorities should take into account in applying the methodology the time required to develop and attract liquidity to both new and existing commodity derivatives and, in particular, for commodity derivatives that may support risk management in bespoke or immature markets or seek to develop new hedging arrangements in new commodities. Given the broad range of markets and commodities to which the position limits regime applies, there is no single and predetermined time period which adequately captures the shift from a commodity derivative contract being new to being established. Equally, there are many commodity derivative contracts which may never attract sufficient participants or liquidity to enable the effective application of position limits without the risk of participants regularly and inadvertently breaching the limit and consequently disrupting the pricing and settlement of those commodity derivatives. In order to address these risks to the efficient functioning of markets, the methodology provides for a tiered approach whereby the position limit for the spot month and for other months is set at a fixed level of 2 500 lots for commodity derivatives and 2,5 million securities in issue for securitised derivatives with a commodity underlying until a threshold of 10 000 lots or 10 million securities, respectively, is exceeded. Contracts exceeding these thresholds while still being relatively illiquid should, where appropriate, be able to benefit from a higher limit in order to ensure that trading in such contracts is not unduly constrained.

(18) The number, composition, and the role of market participants in a commodity derivative can influence the nature and the size of positions that certain market participants hold in the market. For some commodity derivatives, certain market participants might hold a large position which reflects their role in the buying and selling of, and the delivery of, the commodity when they are on the opposite side of the market to the majority of other market participants providing liquidity or risk management services for the underlying commodity market.

(19) The supply, use, access to, and availability of the underlying commodity are characteristics of the underlying commodity market. Through the assessment of more granular components of these characteristics, such as perishability of the commodity and method of transportation, the competent authority can determine the flexibility of the market and adjust position limits appropriately.

(20) For some commodity derivatives there may be a large discrepancy between open interest and deliverable supply. This may occur where there is relatively little derivative trading compared with the deliverable supply, in which case open interest will be smaller in comparison with deliverable supply, or, for example, where a particular commodity derivative is widely used to hedge many different risk exposures and deliverable supply is therefore smaller in comparison with open interest. Such significant discrepancies between open interest and deliverable supply justify adjustments from the baseline applicable to the other months' limit upwards or downwards in order to avoid a disorderly market when the spot month approaches.

(21) With the same objective of limiting disorderly markets as the spot month approaches because of large discrepancies between calculations of deliverable supply and open interest, deliverable supply is defined to include any substitute grades or types of a commodity that can be delivered in settlement of a commodity derivative contract under the terms of that contract.

(22) The new legislation of the European Parliament and of the Council on markets in financial instruments set out in Directive 2014/65/EU and Regulation (EU) No 600/2014 applies from 3 January 2017. To ensure consistency and legal certainty, this Regulation should apply from the same date.

(23) This Regulation is based on the draft regulatory technical standards submitted by ESMA to the Commission.

(24) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council[(3)],

HAS ADOPTED THIS REGULATION:

Modifications etc. (not altering text)

C1 The “appropriate regulator” has power to make such provision as they consider appropriate by means of an instrument in writing to prevent, remedy or mitigate any failure of the provisions of this Regulation to operate effectively or any other deficiency arising from the withdrawal of the United Kingdom from the EU, see The Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (S.I. 2018/1115), regs. 2, 3, **Sch. para. 39** (with saving on IP completion day by S.I. 2019/680, regs. 1(2), **11**; 2020 c. 1, **Sch. 5 para. 1(1)**)

C2 Regulation: power to modify conferred (11.7.2023) by Financial Services and Markets Act 2023 (c. 29), ss. 3, 86(3), **Sch. 1 Pt. 3**; S.I. 2023/779, **reg. 2(d)**

(**1**) OJ L 173, 12.6.2014, p. 173.

(**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) No 648/2012 (OJ L 173, 12.6.2014, p. 84).

(**3**) 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 (OJ L 331, 15.12.2010, p. 84).

Changes to legislation:
Commission Delegated Regulation (EU) 2017/591, Introductory Text is up to date with all changes known to be in force on or before 02 August 2024. There are changes that may be brought into force at a future date. Changes that have been made appear in the content and are referenced with annotations.
EUR 2017 No. 591 may be subject to amendment by EU Exit Instruments made by the Financial Conduct Authority under powers set out in The Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (S.I. 2018/1115), regs. 2, 3, Sch. Pt. 1. These amendments are not currently available on legislation.gov.uk. Details of relevant amending instruments can be found on their website/s.