EEX Group response Public consultation on the review of the MiFID II / MiFIR regulatory framework

European Energy Exchange
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Section 1. General questions on the overall functioning of the regulatory framework

Question 1. To what extent are you satisfied with your overall experience with the implementation of the MiFID II/MiFIR framework?

☐ 1 - Very unsatisfied
☒ 2 - Unsatisfied
☐ 3 - Neutral
☐ 4 - Satisfied
☐ 5 - Very satisfied
Don't know / no opinion / not relevant

Question 1.1 Please explain your answer to question 1 and specify in which areas would you consider the opportunity (or need) for improvements:

As already stated at earlier occasions, EEX Group fully agrees with the objectives of MiFID II / MiFIR and the G20 Pittsburg commitments to "improve the functioning and transparency of financial and commodity markets and address excessive commodity price volatility". However, more than two years after the implementation of the MiFID II / MiFIR framework, we feel these objective have not yet fully materialised in the commodity derivatives markets.
More precisely, while we support the aim and implementation of position limits and pre-trade transparency regimes, we believe their current calibration hampers a substantial increase in contracts traded on exchanges and cleared through central counterparties, which would ensure a high level of security and transparency. Therefore, it is crucial that this review exercise is done with a view to ensure that the legislative framework becomes fit for purpose aiming at creating an efficient high-quality ecosystem that fosters sustainable economic growth – notably in light of new political, economic and climate reality at European and global level.

Against this background, EEX Group would like to highlight that well-functioning commodity markets are prerequisite to a successful development of the international role of the Euro and an increased share of euro-denominated transactions in energy commodities. These markets provide for the hedging of risks based on a robust and transparent process, limiting costs for end-users and increasing efficiency. In this context, we welcome the Commission's recognition of the constraints posed by the position limit regime for commodity derivative contracts on the emergence and growth of Euro-denominated markets that allow hedging price risks stemming from e.g. the long-term investments to tackle climate change.

With all this in mind – and in line with ESMA's proposal to simplify the regime to the extent possible with the aim to make it work more efficiently for market participants and competent authorities, as laid down in its recent review report on this topic – EEX Group suggests a refocus of the position limits regime to fit the legislative objectives and address the unintended consequences on new and illiquid commodity derivative contracts. This can be achieved by focusing the application of the regime on a more limited set of mature ('critical') benchmark contracts relevant for price formation in the underlying commodity.
Such a refocus of the position limits regime on critical contracts would be more efficient, and help mitigate the unintended consequences of the current regime and reduce the compliance burden for all concerned parties (market participants, trading venues, NCAs/ESMA). Most

importantly, such a targeted approach would allow new and nascent products to develop, in line with the policy objective of the Directive as expressed in its implementing RTS 21: "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". It would allow more volumes traded on the regulated markets, contributing to a more transparent trading environment needed for a cost-efficient energy transition. In light of the existing inflexible treatment of new and illiquid contracts, we appreciate ESMA's acknowledgement of the long process of this review and therefore welcome short term amendments to RTS 21 which we deem highly necessary to mitigate the negative impact of the current regime.

A robust, crisis-proof trading system, combined with sound policies to ensure a fair and orderly market, is essential under any market circumstances but especially in the current COVID-19 crisis. Therefore, we believe the Commission should go forward with the planned Level 1 changes, whereby the Level 2 treatment of illiquid contracts should be reviewed as soon as possible.

Finally, it is important to understand that commodity derivative markets have specific characteristics and hence, often suffer from a one-size fits all regulatory approach to financial instruments. MiFIR rightly recognises that certain exemptions can be granted to trading venues from the general requirement to publish pre-trade transparency data to preserve orderly price discovery processes and allow in particular illiquid and nascent markets to develop. However as currently tailored, their methodologies at times limit pre-negotiated trades in nascent contracts from being submitted to exchanges for central clearing, thereby limiting the ability of market participants to hedge their commercial exposures on exchanges. Hence, we recommend a review of the current ill-calibrated waiver thresholds methodology in RTS 2. In this way, the regime would allow for pre-negotiated trades of the most illiquid and new contracts to be brought to an exchange and subsequently familiarize commodity traders with the beneficial features of increased transparency and secure on-venue trading.

Question 2. Please specify to what extent you agree with the statements below regarding the overall experience with the implementation of the MiFID II/MiFIR framework?

	1 (disagree)	2 (rather not agree)	3 (neutral)	4 (rather agree)	5 (fully agree)	N.A.
The EU intervention has been successful in achieving or progressing towards its MiFID II/MiFIR objectives (fair, transparent, efficient and integrated markets).	☐	☒	☐	☐	☐	☐
The MiFID II/MiFIR costs and benefits are balanced (in particular	☐	☒	☐	☐	☐	☐

regarding the regulatory burden).						
The different components of the framework operate well together to achieve the MiFID II/MiFIR objectives.	☒	☐	☐	☐	☐	☐
The MiFID II/MiFIR objectives correspond with the needs and problems in EU financial markets.	☐	☒	☐	☐	☐	☐
The MiFID II/MiFIR has provided EU added value.	☐	☒	☐	☐	☐	☐

Question 2.1 Please provide qualitative elements to explain your answers to question 2:

EEX Group fully agrees with the above mentioned MiFID II/MiFIR objectives and aims to contribute to fair, transparent, efficient and integrated commodity markets. However, as specified in Q1 and Q69-Q76, we believe certain aspects of the current regime prevent these objectives from fully materialising within commodity derivatives markets.

Thereby, the implementation and compliance with MiFID II/MiFIR has proven to be a burdensome and costly process for both commodity derivatives exchanges and market participants. At the same time, the benefits of its implementation, especially regarding the position limits regime, to the markets and end consumers appear limited.

The position limits regime has worked mostly well for mature benchmark contracts and we see a potential for the regime to contribute to the prevention of excessive speculation adversely affecting prices. However, as currently set up, the regime introduced adverse effects on the development of new and nascent contracts:

1) The de minimis limit of 2.500 lots becomes too restrictive when a contract comes close to 10.000 lots of open interest. In that way, market participants have rather been discouraged from on-venue trading, limiting the execution of trades, which could have a negative impact on the orderly pricing of contracts, as well as on the general transparency in the market.;
2) The lack of flexibility in the rules for NCAs to deal with special circumstances – by for example not using a more forward-looking approach to the calculation of open interest used as a baseline for setting position limits.;
3) The slow pace with which bespoke limits are set and reviewed, leading to an incorrect categorisation and unduly restrictive limits; and
4) The fact that the hedging exemption is only available for non-financial entities, even though financial entities often engage in genuine hedging activities.

Moving to a more limited scope of the position limits regime, in combination with an extended hedging exemption, would address the negative unintended consequences addressed in this response and our responses to ESMA's complementary call for evidence and consultation paper on the MiFID II review report on position limits and position management, while preserving the integrity and functioning of the market. It would lead to more volumes traded on the regulated markets, contributing to a more transparent trading environment.

Additionally, we believe that a more tailored pre-trade transparency regime would better promote liquidity and competitiveness in European commodity markets. As currently tailored, the pre-trade transparency regime in certain cases limits pre-negotiated trades in nascent or illiquid contracts from being concluded on exchanges and submitted for central clearing, constraining the ability of market participants to hedge their commercial exposures on exchanges. A more fitting methodology for setting LIS thresholds and assessing liquidity would be better suited for the commodity markets' reality.

Finally, commodity derivatives are by nature global products that are traded in a highly competitive environment. The introduction of the position limits regime as currently calibrated has negatively impacted the EU's competitive position compared to other jurisdictions. It is therefore important to further allow development of an EU-based commodity-trading sector, as it also helps to increase the role of the euro as a denominating currency and can avoid the lock-in of trading into non-European infrastructure exposed to third-country influence.

Question 3. Do you see impediments to the effective implementation of MiFIDII/MiFIR arising from national legislation or existing market practices?

☐ 1 - Not at all
☐ 2 - Not really
☐ 3 - Neutral
☐ 4 - Partially
☐ 5 - Totally
☒ Don't know / no opinion / not relevant

Question 4. Do you believe that MiFID II/MiFIR has increased pre- and post-trade transparency for financial instruments in the EU?

☐ 1 - Not at all
☒ 2 - Not really
☐ 3 - Neutral
☐ 4 - Partially
☐ 5 - Totally
☐ Don't know / no opinion / not relevant

Question 4.1 Please explain your answer to question 4:

Notwithstanding the already considerable efforts and subsequent move in the right direction, EEX Group believes that the level of transparency could still be improved in commodity derivative markets. Notably, by adapting and thereby improving the current position limits and pre-trade transparency regimes.

As stated in our response to ESMA's complementary call for evidence and consultation paper on the MiFID II review report on position limits and position management as well as to Q69-75, a refocussed scope of the position limits regime on a set of mature critical contracts would address the regime's current negative unintended consequences on new and nascent contracts. Subsequently, this would lead to more volumes being traded on the regulated markets, contributing to a more efficient and transparent trading environment. Second, we believe a review of the current waiver thresholds methodology in the pre-trade transparency regime would facilitate an increase in transparency even more. In this way, the regime would allow for pre-negotiated trades of the most illiquid and new contracts to be brought to an exchange and subsequently familiarize commodity traders with the beneficial features of increased transparency and secure on-venue trading. As further elaborated on in our response to Q76 (and ESMA's current consultation paper on MiFID transparency regime for non-equity instruments), this is an essential intermediate step to bring more volumes to the cleared market under the exchange rules.

Question 5. Do you believe that MiFID II/MiFIR has levelled the playing field between different categories of execution venues such as, in particular, trading venues and investment firms operating as systematic internalisers?

☐ 1 - Not at all
☐ 2 - Not really
☐ 3 - Neutral
☐ 4 - Partially
☐ 5 - Totally
☒ Don't know / no opinion / not relevant

Question 6. Have you identified barriers that would prevent investors from accessing the widest possible range of financial instruments meeting their investment needs?

☐ 1 - Not at all
☐ 2 - Not really
☐ 3 - Neutral
☐ 4 - Partially
☐ 5 - Totally
☒ Don't know / no opinion / not relevant

Section 2. Specific questions on the existing regulatory framework

IV. Commodity markets

Question 69. Please specify to what extent you agree with the statements below regarding the experience with the implementation of the position limit framework and pre-trade transparency?

	1 (disagree)	2 (rather not agree)	3 (neutral)	4 (rather agree)	5 (fully agree)	N.A.
The EU intervention been successful in achieving or progressing towards improving the functioning and transparency of commodity markets and address excessive commodity price volatility.	☒	☐	☐	☐	☐	☐
The MiFID II/MiFIR costs and benefits with regard to commodity markets are balanced (in particular regarding the regulatory burden).	☐	☒	☐	☐	☐	☐
The different components of the framework operate well together to achieve the improvement of the functioning and transparency of commodity markets and address excessive commodity price volatility.	☒	☐	☐	☐	☐	☐
The improvement of the functioning and transparency of commodity markets and address excessive commodity price volatility correspond with the needs and problems in EU financial markets.	☒	☐	☐	☐	☐	☐

The position limit framework and pretrade transparency regime for commodity markets has provided EU added value.	☐	☒	☐	☐	☐	☐

Question 69.1 Please provide both quantitative and qualitative elements to explain your answer and provide to the extent possible an estimation of the benefits and costs. Where possible, please provide figures broken down by categories such as IT, organisational arrangements, HR etc.

Quantitative elements for question 69.1:

	Estimate (in €)
Benefits	
Costs	Both the one-off implementation and the annual maintenance costs are estimated at a 1-digit million EUR figure each. This includes internal and external resources in terms of IT projects, technical requirements, compliance, reporting and surveillance costs. As this assessment relates to one venue, the total costs for the industry should thus be multiplied by the number of actors as this has to be done individually and there is very little synergy in implementing the requirements. Furthermore, this exchange-based assessment does not include the implementation costs for market participants, which in total is likely to be an even higher number than for exchanges due to the substantially higher number of actors. Importantly, however, this cost assessment does not include the costs of the slowed growth of commodity derivatives markets in Europe because of the hampering effects of MiFID II / MiFIR. This is estimated as by far the biggest cost of the regime, while difficult to quantify precisely. [Please refer to our response to Q69.1 below for a more extensive qualitative explanation.] As stated above, an exact cost assessment including indirect costs is very difficult to provide. However, when taking the direct costs into account, the overall cost of the two regimes should be assumed between 50 million to 100 million EUR and when also looking at the indirect costs, a loss of 250 million to 500 EUR seems most realistic.

Qualitative elements for question 69.1:

EEX Group fully agrees with the objecives of MiFID II/MiFIR to “improve the functioning and transparency of commodity markets and address excessive commodity price volatility”. However, we feel these objectives have not yet fully materialised within the respective regimes.

The establishment of and compliance with MiFID II/MiFIR has proven to be a burdensome and costly process for both commodity derivatives exchanges and market participants. As explained above, implementing and running both regimes has cost several millions for EEX Group. Operating costs for exchanges and market participants are especially large. An additional cost derives from the duplicative reporting infrastructure and connection to competent authorities and their maintenance. Compared to the small added value to the integrity and functioning of the market, the compliance burden today seems disproportionate. Indeed, already today, contracts are subject to extensive monitoring and reporting based on REMIT and MAR principles. In addition to our indications, indirect costs following from the prevention of growth of commodity derivatives markets should be highlighted. Contrary to the general intention of EU financial policy to bring more trades onto regulated markets in order to increase safety, efficiency and transparency, notably the position limits regime has slowed-down growth at exchanges. At the same time, the benefits of the implementation of MiFID II/MiFIR to the markets and end consumers are small as of today.

Where the position limits regime has worked mostly well for mature benchmark contracts, it has introduced adverse effects on the development of new and nascent contracts. Following restrictive (de minimis) limits and a lack of flexibility, market participants have rather been discouraged from on-venue trading, limiting the execution of trades, which could have a negative impact on the orderly pricing of contracts, as well as on the general transparency in the market. Specific regulators in Europe have taken this into account by changing limits for nascent contracts from 2,500 lots into a “tba” status in order to give the contract time for development, however leading to an unequal treatment within the EU. Relating to the negative impact of the position limit regime on the business climate in Europe, the regime has significantly reduced the chances that additional benchmark commodity derivative contracts develop inside the EU, making the subsequent costs far greater than merely the absence of the associated trading activity. Commodity derivatives are by nature global products that are traded in a highly competitive environment. The current calibration of the position limit regime has thereby negatively impacted the EU’s competitive position compared to other jurisdictions.

Against this background - and in line with ESMA’s proposal to simplify the regime to the extent possible with the aim to make it work more efficiently for market participants and competent authorities, as laid down in its recent review report on this topic - EEX Group sees clear merit in limiting the application of the regime to a restricted set of mature, critical, benchmark contracts.

Additionally, we believe that a more tailor-made pre-trade transparency regime would foster liquidity and competitiveness of EU commodity markets. Commodity markets differ from classic financial markets and hence often suffer from a one-size fits all regulatory approach to the regulation of financial instruments. As currently tailored, the pre-trade transparency regime in certain cases limits pre-negotiated trades in nascent or illiquid contracts from being concluded on exchanges and submitted for central clearing, constraining the ability of market participants to hedge their commercial exposures on exchanges. A more fitting methodology for setting LIS thresholds and assessing liquidity would be better suited for the commodity markets’ reality.

Our answers to Q70 on the position limits regime and to Q76 on the pre-trade transparency regime, together with our responses to ESMA's complementary consultations, provide additional examples on the current functioning and shortcomings of the two regimes.

Against this background, we explicitly welcome the European Commission's recognition of the role of European commodity markets in strengthening the role of the Euro and Euro-denominated products. For both promoting new contracts and fostering liquidity in contracts that are already denominated in Euro, it is key that the Eurozone as such is attractive for market participants and its regulatory framework is fit for purpose. More proportionate and efficient position limits and pre-trade transparency regimes would contribute significantly to the competitiveness of globally-connected EU commodity markets.

1. Position limits for illiquid and nascent commodity markets

Question 70. Can you provide examples of the materiality of the above mentioned problem?

☒ Yes, I can provide 1 or more example(s)

☐ No, I cannot provide any example

Please provide example(s) of (nascent) contracts where the position limit regime has constrained the growth of the contract:

Underlying cause of the constraint (A/B/C)*:

*Note: 1 The underlying cause of the constraint is due to (A) the position limit becoming too restrictive as open interest increases, (B) an incorrect categorisation under the position limits framework or (C) the underlying physical markets are not efficiently reflected.

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The position limits regime in its current form has a substantial impact on the development of new/less liquid products and growth of existing commodity derivatives markets as we observed a stagnation in markets of which we believe they would have been more liquid otherwise. We largely agree with the three underlying causes of constraints as indicated in this question: A) the de minimis rule of 2,500 lots becomes too restrictive when a contract comes close to 10,000 lots of open interest (OI); b) an incorrect categorization caused by a slow pace with which a contract is considered liquid and hence receives a bespoke limit, or a flawed liquidity assessment following lot sizes that do not reflect market realities; and c) the lack of flexibility for NCAs to deal with special circumstances occurring in the underlying markets. And whilst in theory, in line with ESMA Q&As, NCAs can use derogations for illiquid markets with an OI between 5,000 and 10,000 lots, these are difficult to apply in practice and are often not sufficient to mitigate the negative impact of unduly low limits. In addition, we want to highlight the damaging fact that the hedging exemption is only available for non-financial entities, even though financial entities engage in genuine hedging activities.

[Please refer to our complementary response to ESMA's Call for Evidence for more extensive details per asset class.]

<u>Dry Bulk Freight</u>

The most important reason for position limits having hampered the development of EEX freight contracts, is that for more critical clients - on which the take-off of a contract is fundamentally dependent - the de minimis rule is too restrictive (a). Figure 1 in Annex I gives the example of Capesize 5TC, where after a strong growth in OI, the 2,500 lots limit hampered the development of the contract as soon as the OI approached 10,000 lots. A second reason is the slow pace with which a contract is classified from illiquid to liquid and hence, receives a bespoke position limit (b). Figure 2 provides the example of Panamax 4TC, which received a bespoke limit months after becoming liquid. Finally, the lack of flexibility in the rules for NCAs to deal with special circumstances (c). EEX freight contracts are going through the process of transferring to an index that is more representative of the underlying markets e.g. from Capesize 4TC to Capesize 5TC. Until the market has switched to the new product, the old and new index contracts run in parallel. The inability of NCAs to consider 4TC and 5TC as the same contracts but rather 5TC as new contract subject to the de minimis rule, has resulted in limit breaches and clients having stopped trading as liquidity is unsatisfactory.

Gas

In the gas market, the main reason for the position limits having hampered the development of contracts is the restrictive de minimis limit of 2,500 lots OI (a). This occurs together with an inflexible categorization (b) or inadequate representation of the underlying market (c). Figure 3 gives the example of a market with an OI oscillating between 5,000 and 20,000 lots with periods where the 2,500 lots limit represented only 12.5% of OI. This follows the strict definition of a liquid contract and the slow pace with which contracts receive a bespoke limit. Additionally, financial entities, are unable to benefit from the hedging exemption. In these cases the 2,500 lots OI limit hampered the development of contracts. Please see Q75 for a detailed example.
Finally, if the definition of lots does not sufficiently follow economic considerations, the limit might be artificially low and a market might be artificially liquid or illiquid. The lot size definition of gas contracts follows the rules of nominating gas, which are defined by the operators of virtual trading point (not by exchanges), and which differ among member states.

Power

In power, three elements hampered the development of liquid contracts; The slow pace with which bespoke limits are set and reviewed (b); The lack of flexibility in the rules for NCAs to deal with special circumstances (c), and; The relatively complex process to apply for the hedging exemption in Germany.
For power contracts that became liquid after MiFID II implementation, the time between the contracts exceeding 10,000 lots open interest during three consecutive months and the contracts receiving a bespoke limit on average amounted to two to three months. Figure 4 gives the example of the Romanian Base Power contract which became liquid in June 2019, but has not yet received a bespoke limit. Finally, at the end of 2017 following the underlying bidding zone split, EEX split its Phelix German/Austrian benchmark contract into a German and Austrian power future. Although expected that the liquidity of the German product would soon pick up after launch, the position limit regime does not allow a forward-looking approach to determine the open interest on which the position limit should have been set.

Size of the OTC space the contract(s) is/are trying to enter (in €):

Power and gas markets are usually separated by “market areas” (power) or “hubs” (gas). These market areas and hubs in most cases correspond to a country, meaning that there is for example one gas market for France. The share of cleared transactions ranges from 0-90%, depending on the underlying and the market. The size of the OTC space might therefore be identical to the size of the market (for example UK power market) or might only constitute a relatively low share (for example Italian power market). And then, the markets itself can be large or small.

In essence, we believe that also in small markets, like Belgium, market participants should have the opportunity to trade cleared derivatives on a liquid market – independently of the size of the OTC space in such a market. However, this is today impossible, since the position limits for illiquid markets consistently hamper the growth in such markets.

Market share the nascent contract(s) is/are expected to gain (in %):

The future market share of a nascent contract depends on the market itself and the underlying commodity of that market, and is difficult to predict in detail beforehand.
In some markets, the introduction of cleared derivatives trading has led to a very large increase of on-venue trading in only some years, for example in the Italian power market. In this specific example, the market is populated by a large number of small-to-medium sized players for whom exchange trading represents an opportunity to trade anonymously with all other members and mitigating otherwise potential risks regarding access to credit. In addition, trade registration has played a detrimental role in establishing trust, by registering pre-negotiated trades on the exchange for execution and clearing, thereby mitigating any counterparty risk.

In other markets, this development did not take place, for example in the Belgian gas market. We believe that this is partly due to the strict position limits for illiquid markets and the inability of financial counterparties to hedge their commercial risks sufficiently as outlined in our answers to the previous and following answers.

For these markets, a liquid market is of utmost importance to allow market participants to efficiently hedge their risks and benefit from optimal trading opportunities. Discouraging these players from entering or staying on the markets would decrease trust in settlement prices or make then more difficult to achieve.

We stand ready to answer any questions the Commission might have on specific asset classes.

Contract(s) is/are euro denominated?

EEX Group runs markets in Europe, Asia and North America and is home to trading in different currencies. This is why making decisions on whether to launch a new EEX Group contract denominated in euro or in another currency is part of our everyday business. EEX Group's offering comprises markets for energy, agriculture, freight, metals, and environmentals, including the EU Emissions Trading Scheme.

Today, the vast majority of commodity derivatives listed at EEX Group are denominated in Euro. Notable exceptions are future markets relating to freight, Japanese power, LNG and UK power and gas.
However, commodity derivatives are by nature global products that are traded in a highly competitive environment. The introduction of the position limit regime as currently calibrated has negatively impacted the EU's competitive position compared to other jurisdictions (please see

our response to Q69.1). It is therefore important to further allow development of an EU-based commodity-trading sector, as it also helps to increase the role of the euro as a denominating currency and can avoid the lock-in of trading into non-European infrastructure exposed to third-country influence. The currency for derivatives follows that which is the standard for the underlying physical market.

Question 71. Please indicate the scope you consider most appropriate for the position limit regime:

	1 (most appropriate)	2 (neutral)	3 (least appropriate)	N.A.
Current scope	☐	☐	☒	☐
A designated list of 'critical' contracts similar to the US regime	☒	☐	☐	☐
Other	☐	☐	☐	☐

Question 71.1 Please explain your answer to question 71:

EEX Group believes that to effectively overcome the negative impact of the current regime, a fundamental review is indeed necessary. We consider that to solve the issues we have outlined in our responses to this consultation as well as to ESMA's complementary consultations, we need to move towards a more proportionate and efficient position limit regime. This can be achieved by refocusing on a more limited set of mature, critical, benchmark commodity derivative contracts. Such a refocus would ensure that the goals of the position limit regime are met, mitigate the current unintended consequences for nascent and illiquid contracts and reduce the compliance burden for all concerned parties (market participants, trading venues, NCAs/ESMA).

First, as outlined in detail in our complementary responses to the ESMA Consultation and Call for Evidence, we believe the regime could contribute to the MiFID objective of avoiding excessive speculating adversely affecting prices rather than to the prevention of market abuse or improved orderly pricing and orderly settlement. For this, it is sufficient to consider mature products which serve as a benchmark in their respective markets and are relevant for the price formation for the underlying commodity. New and nascent products are unlikely to influence price movements in the underlying physical commodity market and thus they cannot negatively impact consumers. The same approach is also taken in the US position limits regime. This view is also shared by ESMA which, in its recent MiFID II review report on position limits and position management, acknowledges that *"the scope of position limits should be limited to commodity derivatives where position limits can play of valuable role, i.e. to well-developed critical contracts where price formation takes place and that have a role in the pricing of the underlying commodity and other related commodity derivatives."*

Additionally, a focused scope would allow new and nascent contracts to develop and mitigate the current constraints. This contributes directly to the policy objective of the Directive as expressed in its implementing RTS 21: "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".
Moreover, all contracts would remain subject to the position reporting regime under MiFID II Art. 58, the pre-existing position monitoring and position management measures by exchanges and the market oversight practices of the exchanges' market supervision and market surveillance departments that apply the principles laid down in the Regulation on Energy Markets Integrity and Transparency (REMIT) and the Market Abuse Regulation (MAR). Thus, removing position limits for certain contracts would not pose a risk to the transparency and functioning of the respective markets or undermine the goals of the regime. On the contrary, attracting more volume onto exchanges would contribute to a more transparent and safer trading environment.

Third, we believe this would increase the competitiveness and liquidity of European commodity markets. Contracts on third country venues are often near-perfect, more liquid substitutes for EU derivatives, leaving EU trading venues with a competitive disadvantage following the stringent limits. From this perspective, given the majority of commodity trading is happening outside the EU, as presented by ESMA in their Review Report, similar contracts listed on third-country exchanges should be taken into account when determining an EU specific list of critical benchmark contracts.

In this context, we also support ESMA's proposal for a more pragmatic approach towards competing critical contracts on different venues with the same characteristics and physical underlying and believe that this, in combination with a reduced scope, will solve potential competitive disadvantages between EU exchanges. The definition of "same contract" does not reflect the commodity derivatives markets' reality. Instead, the open interest figure which serves as a basis for setting the other month's limit could be provided by the trading venue providing the critical contract that has the highest average open interest over a certain period, i.e. one year.

In sum, we believe that limiting the scope of the application of the position limits regime to 'critical' contracts will address the issues brought forward in Q70 and ESMA's complementary consultations. It would lead to more volumes being traded on the exchanges, contributing to a more transparent trading environment needed for a cost-efficient energy transition. Lastly, a more efficient regime would contribute to the European Commission's objective to strengthen the competitiveness of European commodity derivatives markets in the context of the international role of the Euro.

Finally, mindful of the long process this review could entail, we strongly support ESMA in its recommendation of a two-tier approach that short term amendments to RTS 21, and notably Art. 15, are needed to already mitigate the negative impact of the regime on nascent and illiquid contracts while the more fundamental reform is dealt with as part of the Level 1 review.

Question 72. If you believe there is a need to change the scope along a designated list of 'critical' contracts similar to the US regime, please specify which of the following criteria could be used.
For each of these criteria, please specify the appropriate threshold and how many contracts would be designated 'critical'.

☒ Open interest

☐ Type and variety of participants
☐ Other criterion:
☐ There is no need to change the scope

Open interest:
Threshold for open interest:

EEX Group considers that a contract should have at least 300.000 lots of open interest on average over one year to qualify as ‘critical’.

Number of affected contracts in the EU for open interest:

Based on 2019 (pre-Brexit) figures, more than twenty commodity derivative contracts.

Please explain why you consider that the open interest is a criterion that could be used:

Exchanges use various, often highly correlated, criteria to assess the liquidity of a market. They include, inter alia, open interest, share of open interest versus deliverable supply, number of active trading participants, churn ratio (for physically-delivered contracts), share of screen execution and average trading horizon. Open interest is in this regard the most relevant and most often referred to. Therefore, EEX Group considers a commodity derivative contract to be ‘critical’ once it has developed into a highly liquid instrument with open interest levels that imply that all the various more detailed liquidity criteria have been met.

Based on these criteria which exchanges use to determine which markets should be considered mature and developed, EEX Group recommends a contract should have at least 300,000 lots of open interest on average over a year to qualify as ‘critical’. This number should serve as a minimum threshold which qualifies a contract to the position limits regime and should be assessed against a deeper market understanding. Please refer to our response to Q72.1 for more details.

Type and variety of participants:

In relation to the “type and variety of market participants”, in the interest of transparency and simplicity of the regime, we recommend that this criterion is not considered. However, should the Commission wish to take it into account in addition to open interest, we recommend that there should be at least 50 active trading market participants in a contract on average over a one-year period. This number of market participants is also a factor to be considered by NCAs when setting position limits under the implementing legislation of Art. 57 MiFID II. To qualify as “critical”, a contract would have to breach both thresholds for open interest and actively trading participants.

Question 72.1 Please explain your answer to question 72:

As specified above, open interest is the most important indicator for exchanges to determine whether an instrument is highly liquid and mature. When assessed in function of the market reality, it shows the potential of instruments to serve as a benchmark contract for the underlying commodity.

ESMA rightly points out in its review report that, in a post-Brexit environment, a more limited amount of benchmark commodity derivative contracts will reside in the European Union. However, we would like to urge the European Commission and the co-legislators to refrain from artificially classifying contracts as critical. This would hinder the development of genuinely critical commodity derivative contracts in the European Union and thereby at best maintain the status quo. Rather than designing thresholds to cover a wider range of contracts, European policy-makers should ensure that the EU financial services legislation is proportionate and effective. A reduced scope to genuine 'critical' mature contracts, identified by using 300,000 lots open interest as a reference minimum threshold, would allow Euro-denominated commodity derivative contracts to develop into European and global benchmark contracts.

In case the Commission may wish to take more criteria into account, we believe taking a two-tier approach would be most appropriate. The open interest figure on average over one year should hereby serve as a strict minimum threshold to qualify contracts for the regime. This gives NCAs and ESMA the opportunity to, in a second step, assess the 'critical nature' of these highly liquid contracts and set bespoke limits based on a deeper market understanding. This was previously impossible due to the enormous number of contracts for which limits needed to be defined. Such approach ensures that only mature products that are able to function well under the position limit regime receive an appropriate limit and 'critical' status, while nascent contracts are given the opportunity to further develop.

This second determination step should take into account whether the price signal of a 'critical' contract is broadly recognised in the wider market as a relevant benchmark price for its underlying commodity. Thereby, it is particularly important to consider the existence of non-EU derivatives markets with the same underlying commodity. If a market has developed elsewhere for the same underlying commodity, there is a risk that the non-EU market attracts the liquidity of the EU-based market. Lastly, we would support looking at the underlying commodity in order to fulfil the objective to avoid excessive speculation adversely leading to price volatility. As highlighted in our response to ESMA's consultation on the position limits regime, it should be noted that it is not scientifically proven that excessive speculation leads by default to price volatility. While for some (agriculture) contracts, in particular time frames, this has been demonstrated, for others it was price volatility that cause excessive speculation, while in further cases there was a bilateral relationship.

We appreciate ESMA's recommendation in the Review Report that further work and consultation will need to be undertaken to determine relevant thresholds and ensure that an appropriate number of benchmark commodity derivatives traded in the EU remain subject to the regime. This will allow for more timely adjustments as required by market developments. For this, it is of utmost importance that ESMA consults all relevant actors in the identified commodities' value chain.

Question 73. Do you agree that there is a need to foster convergence in how position management controls are implemented?

☒ 1 - Disagree
☐ 2 - Rather not agree
☐ 3 - Neutral
☐ 4 - Rather agree
☐ 5 - Fully agree
☐ Don't know / no opinion / not relevant

Question 73.1 Please explain your answer to question 73:

We do not consider any further harmonisation of position management controls to be necessary. As position reporting, monitoring, management and control activities are already subject to REMIT, MAR and MiFID II principles, we are convinced there is already sufficient consistency across trading venues. These regulations as well as the establishment of market supervision and market surveillance departments have been effective in preventing market abuse and excessive speculation. To recall from our responses to ESMA's Call for Evidence and complementary consultation, besides being subject to the MiFID II position management regime, exchange-traded gas and power derivatives markets are also under close scrutiny of the exchanges' market supervision and market surveillance departments. The departments apply the principles set out in Regulation on Energy Markets Integrity and Transparency (REMIT) and the Market Abuse Regulation (MAR). While REMIT introduces a sector-specific legal framework for identifying and penalizing insider trading and market manipulation in wholesale energy markets across Europe, MAR establishes a pan-European regime to prevent and detect market abuse, market manipulation and insider dealing in financial markets, including energy derivative markets. It has to be noted that it is the legal responsibility of the EEX Group Market Surveillance Department to ensure that trading processes and pricing are carried out on a fair and manipulation-free basis. In Germany, the Market Surveillance Department is an independent and autonomous body of the exchange, which is only subject to instructions by the Saxon State Ministry of Economic Affairs, Labor and Transport. For example, if the EEX Market Surveillance Department has the justified suspicion that an order or transaction violates the provisions of Articles 3 or 5 of REMIT, it has to inform the national (energy) Market Monitoring Authorities or in case of Articles 14 or 15 of the Market Abuse Regulation (ban on engaging in or attempting to engage in insider dealing or market manipulation), it shall inform the German Federal Financial Supervisory Authority thereof. Another example of position management regimes commonly implemented across exchanges before and since MiFID II are accountability levels. EEX Group has successfully implemented accountability levels which trigger an information request from the trading venue to better understand the reason and intention of the position built and the potential risks attached to it. EEX Group then follows up as appropriate, and potentially asks a person to reduce or terminate a position if no adequate answer is provided. In sum, as the nature of membership as well as characteristics of contracts can diverge substantially across individual exchanges, EEX Group is supportive of the current approach whereby a substantial responsibility for position monitoring, management and control is delegated to exchanges.

Question 74. For which contracts would you consider a position limit exemption for a financial counterparty under mandatory liquidity provision obligations? This exemption would mirror the exclusion of the related transactions from the ancillary activity test.

	Yes	No	N.A
Nascent	☒	☐	☐

Illiquid	☒	☐	☐
Other	☐	☐	☐

Question 74.1 Please explain your answer to question 74:

EEX Group fully supports a position limit exemption for financial counterparties under mandatory liquidity provision obligations, similar to the one outlined in Art. 2(4) of MiFID II. The lack of a liquidity provision exemption in combination with the minimis limit being too restrictive has been a substantial barrier to the development of new contracts, such as EEX agriculture and EEX dry bulk freight contracts. However, we want to reiterate that reducing the regime's scope to critical benchmark contracts receives our highest priority and would in the most efficient manner solve the problems for new and nascent contracts.

However, in case such exemption is considered, it should not be limited to financial counterparties only, but expanded to non-financial counterparties too, as in many cases, if not in most cases, non-financial counterparties fulfil mandatory liquidity obligations as well. The exemption is in particular necessary for new contracts that need financial or non-financial entities to incentivise trading in the contract, at least if the position limit regime continues to include the restrictive 2,500 lots limit on new and illiquid contracts. If no such exemption is available and the 2,500 lots limit continues to apply, exchanges have to contract a "panel" of liquidity providers to ensure that none of these firms exceed the 2,500 lots limit. In nascent markets it is highly possible that there may not be the required number of counterparties to build such a "panel" and even where this is the case, it adds significant costs for the exchange.

In order to avoid such a situation, we recommend that the position limit regime includes such an exemption based on the same conditions as the liquidity provision exemption outlined in Art. 2(4) MiFID II and the ESMA Q&A on MiFID II/MiFIR commodity derivative topics.

Question 75. For which counterparty do you consider a hedging exemption appropriate in relation to positions which are objectively measurable as reducing risks?

	Yes	No	N.A
A financial counterparty belonging to a predominantly commercial group that hedges positions held by a non-financial entity belonging to the same group	☒	☐	☐
A financial counterparty	☒	☐	☐
Other	☐	☐	☐

Question 75.1 Please explain your answer to question 75:

EEX Group fully supports a hedging exemption for both kinds of financial counterparties in relation to positions which are objectively measurable as reducing risks. This, in combination with a focus on 'critical' benchmark contracts would address our concerns with the regime as explained in Q70 and our responses to the complementary ESMA consultation and call for evidence.

Currently, financial entities, though mainly engaging in hedging activities, are unable to benefit from the hedging exemption. Commodity trading houses as well as investment banks play a vital role in providing smaller commercial players with access to commodity derivatives markets. Moreover, also commercial players can be an investment firm under MiFID II. This does not imply that they do not need a hedging exemption anymore for the commercial activities they are undertaking as their main business.

In iron ore and freight, for example, it is possible that a bank would finance a steel mill with the caveat that the business needs to initiate a hedging programme to remove volatility from future costs or revenues (or both). The hedging programme would usually be conducted with the bank on an OTC basis with the bank then offsetting that risk in the cleared market. Even though within the context of such a transaction the bank clearly performs a hedging activity, it would not be able to make use of the exemption envisaged under MiFIR Article 8 or MiFID Article 57.
Figure 5 and 6 (provided in the attached Annex I) illustrates the negative impact of the 2,500 lots limit in combination with the lack of hedging exemption possibilities for financial counterparties on the Gas Czech Virtual Trading Point, CZ VTP, and Zeebrugge Trading Point (ZTP) gas future markets. Both markets took off in the course of 2018, but then declined when the 2,500 lots limit became too restrictive. With only 10 to 12 market participants registered to trading and only 1 or 2 very active market participants being responsible for most of the volumes – an absolutely normal situation for a new contract -, the position limit put a halt to the further development of the contract. Important participants in this example are investment firms, trading gas derivatives to hedge its retail activity. However, because of its classification as investment firm, they have no other option than to stop trading and look for other hedging alternatives. This increases its cost and in turn the cost to end consumers. In such a case, the investment firm should be allowed to benefit from a hedging exemption.

As stated in our responses to the complementary ESMA Call for Evidence and Consultation, exchanges have extensive experience with operating a position management system allowing for exemptions from limits of positions held for genuine hedging purposes by market participants, regardless of their legal status and nature of business. This approach allows commodity market participants to manage their risks efficiently. We believe a similar system, inclusive of financial counterparties, could be operated by financial regulators across the EU all the more given the amount of information they receive about the activities of such entities.

2. Pre-trade transparency

Question 76. Do you consider that pre-trade transparency for commodity derivatives functions well?

☐ 1 - Disagree
☒ 2 - Rather not agree
☐ 3 - Neutral
☐ 4 - Rather agree
☐ 5 - Fully agree
☐ Don’t know / no opinion / not relevant

If you do not consider that pre-trade transparency for commodity derivatives functions well, please (1) provide examples of markets where the pre-trade transparency regime has

constrained the offering of niche instruments or the development of new and/or fast moving markets, and (2) present possible solutions including, where possible, quantitative elements:

As said, EEX Group fully agrees with the objectives of MiFID II/MiFIR and the G20 Pittsburg commitments to "improve the functioning and transparency of financial and commodity markets and address excessive commodity price volatility". While we support the aim and implementation of the pre-trade transparency regime, however, we believe the current calibration could merit a more tailor-made approach to commodity derivative markets. When taking into account the below suggestions, the regime would allow for pre-negotiated transactions of the most illiquid and nascent contracts to be brought to an exchange and to central clearing and subsequently familiarise commodity traders with the beneficial features of increased transparency and security of orderbook trading.

In its current form, the pre-trade transparency regime at times limits pre-negotiated trades in nascent contracts from being submitted to exchanges and to central clearing, thereby in particular constraining the ability of market participants to hedge their commercial exposures on exchanges. The current methodology and its segmentation approach (such as liquidity accumulation across venues) has led to a significant number of niche and nascent products being inappropriately (re-) classified as liquid, and thus becoming subject to significantly broader transparency requirements, which were previously reserved for developed markets.

We therefore recommend that both Level 1 and Level 2 provisions are revised:

Level 1:
We recommend that the hedging exemption pursuant Article 8(1) MiFIR is extended to cover all market participants managing risks arising from activity in the physical market, including financial counterparties. Such a solution would allow to build liquidity and permit market participants to sufficiently hedge their positions which are objectively measurable as reducing risks.

Level 2:
Appropriate amendments in RTS 2 should be made to adjust the factors currently leading to inappropriate qualification of products as liquid and to the LIS thresholds.

First, the inclusion of price in the calculation of LIS threshold values and assessment of liquidity can lead to misinterpretations and confusion when measuring liquidity in instruments that are not natively defined in notional values. Applying notional value as per, for example, the ADNA (Average Daily Notional Amount) across all asset classes has proved to be impractical to an analysis of market liquidity. Moreover, market players typically hedge their production and consumption by trading in lots and not in notional value. Thus, we recommend that any liquidity analysis and in particular the expression of the LIS thresholds is normalised to a base quantity unit that is native to the asset class. For commodities, this will typically be a specific unit of measure (e.g. MW).

Second, in order for a market to be considered liquid, a sufficiently high number of trades should be executed on each trading day. We recommend that the threshold should be set at the median of 100 transactions per day instead of the current average of 10. Considering the fact that liquidity is the ability to find a counterparty in a relatively short period of time within a given trading day, a threshold of 100 trades per day has the practical implication that it represents an average of approximately 1 trade every 5 minutes on an 8-hour trading day. In contrast, a threshold of 10 trades represents just 1.25 trades per hour.

For the same reason, a median is proposed as the minimum instead of a mean. The mean can simply be an alternate view of the sum count of trades per year.

Third, the ADNA does not automatically reflect a large number of trades and thus a high level of liquidity. We suggest to rather look at trade frequency and standard size, excluding unrelated vectors such as price and currency.

Fourth, the current percentile-based approach can lead to significant counterintuitive effects, which is important to keep in mind when setting LIS thresholds. Instruments with lower liquidity cannot support higher LIS levels than high-liquidity instruments. We therefore suggest adapting this approach. In a similar fashion, for many commodity markets, the minimum threshold of 500.000 EUR is not reflective of the currently available liquidity and should be adjusted. By bringing the LIS value more closely in line with the actual market conditions, the overall negative market impact should be reduced.

Finally, we want to reiterate our proposal to separate liquidity assessments by trading venue. Although the illiquid instruments waiver is intended to protect new and illiquid markets, accumulating liquidity across exchanges defeats this purpose. We do not think a liquidity assessment accurately reflects market conditions if an instrument is considered liquid on one venue (although liquidity is low) just because it has been found to be liquid on another venue. This makes it practically impossible to launch a new contract that is already liquid on another exchange.

Question 76.1 Please explain your answer to question 76:

First and foremost, it is important to understand that commodity markets have specific characteristics and hence, often suffer from a “one-size fits all” regulatory approach to financial instruments. MiFIR rightly recognises that certain exemptions can be granted to trading venues from the general requirement to publish pre-trade transparency data to preserve orderly price discovery processes and allow in particular illiquid and nascent markets to develop. However, in its current form, the pre-trade transparency regime at times limits pre-negotiated trades in nascent contracts from being submitted to exchanges and central clearing via trade registration, thereby constraining the ability of market participants to hedge their commercial exposures on exchanges. Hence, we recommend a review of the current ill-calibrated waiver thresholds methodology and a widening of the hedging exemption to also include financial counterparties. In this way, the regime would allow for pre-negotiated trades in the most illiquid and new contracts to be brought to an exchange and subsequently familiarise commodity traders with the beneficial features of increased transparency and security of orderbook trading.

Compared to other financial instruments, commodity instruments are often less liquid. In order to achieve execution on an exchange, trades are often pre-negotiated outside the regulated venues and then brought on to them (and to clearing) via trade registration. This is often more promising, than entering orders into a central order book where a satisfactory execution would be less likely. This ensures maximum transparency for these nascent markets.

Additionally, energy markets are – by nature – characterised by a wide range of different contract types, including , forwards, futures and options with various combinations of e.g. quality, location, delivery type, duration and size. These markets are used by professional investors to hedge risk connected to the production or consumption of an actual commodity, and thus often requires liaison via a broker to find a counterparty without incurring undue risk.

The EEX Spanish power contract (Figure 7 Annex 1) illustrates well how trade registration has been the driver behind volumes shifting from OTC to on-venue trading in new markets. It is important for such markets that thresholds for the waivers are appropriate to allow for a natural move to central order book trading.

Section 3. Additional comments

Question 94. Have you detected any issues beyond those raised in previous sections that would merit further consideration in the context of the review of MiFID II/MiFIR framework, in particular as regards to the objective of investor protection, financial stability and market integrity? Please explain your answer:

In addition, we would like to express our concerns on the impact of Brexit on the MiFID II framework for commodity derivatives and notably the Ancillary Activity Exemption. In case the UK leaves the EU without a relationship in place for financial services which addresses this exemption, the size of the UK commodity markets will not count towards the EU27 overall market size calculations. From 2023 onwards, when the three year backward calculating period will not include UK data anymore, EU27 non-financial trading firms would be unduly exposed to the risk of becoming subject to a MiFID II licensing requirement. This would likely reduce trading activity in the EU in financial instruments, leading to lower liquidity and increasing the costs of risk management for the real economy, thereby hampering the ability to hedge commercial risks efficiently. This trading activity would rather move to direct bilateral OTC markets or to other international markets, leading to a severe competitive disadvantage for EU commodity markets.

Therefore, we strongly encourage the Commission to use the opportunity of the current MiFID II review to ensure European commodity derivative markets will be competitive and to permit a fair development of liquidity. We deem an approach where the current methodology and its thresholds are amended – by for example increasing the thresholds dramatically - does not reasonably address this problem. Contrary, a qualitative commodity markets exemption for non-financial firms would efficiently assess the nature of non-financial firms' trading activities. Therefore, we welcome and support the proposal from ESMA to reconsider the quantitative test approach set out in Art. 2(4) of MiFID II for eligibility to the ancillary activity exemption following the UK departure from the EU.

Annex I

Figure 1 – Impact of the 2,500 lots limit being too restrictive for EEX Capsize 5TC contract

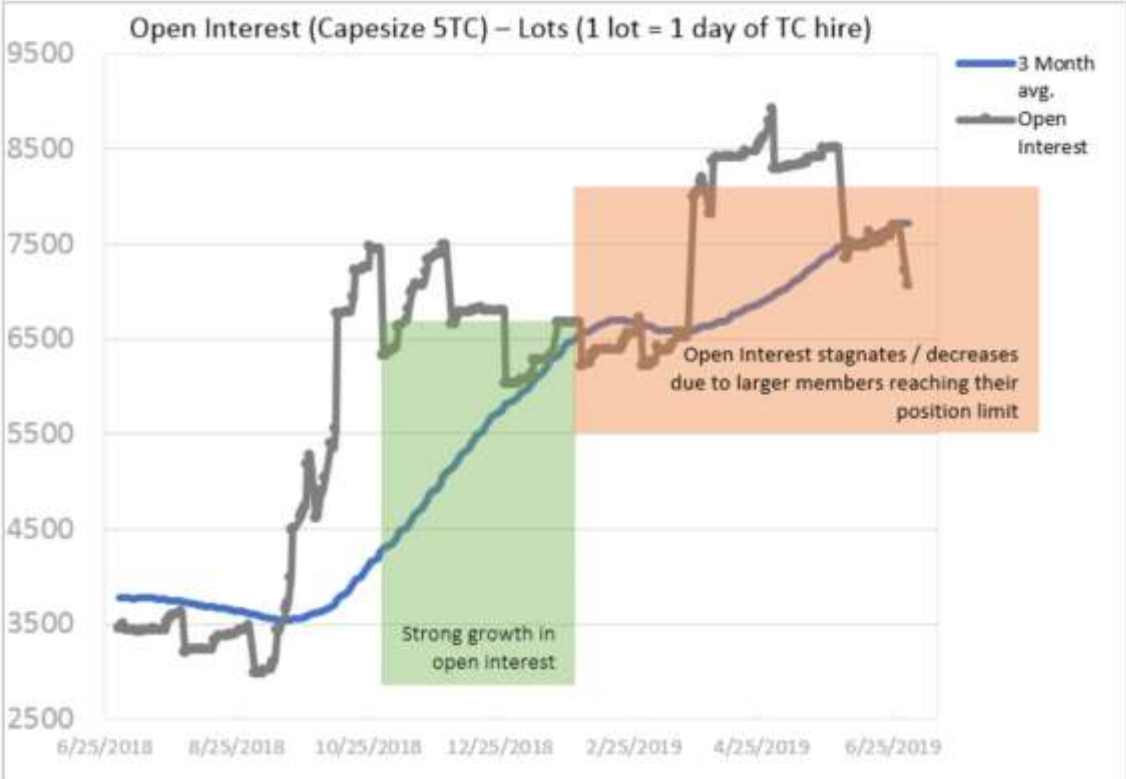

Figure 2 – Impact of slow pace with which the EEX Panamax 4TC contract is classified from illiquid to liquid

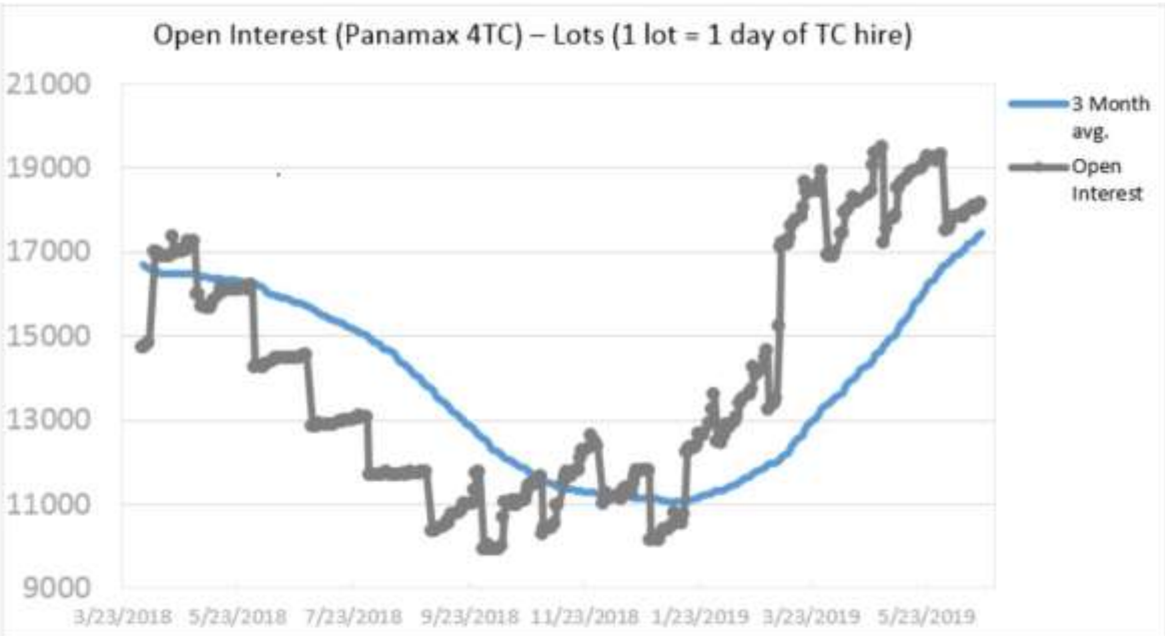

Figure 3 – Impact of the strict definition of a liquid contract in combination with the slow pace with which the CEGH VTP contract was classified from illiquid to liquid

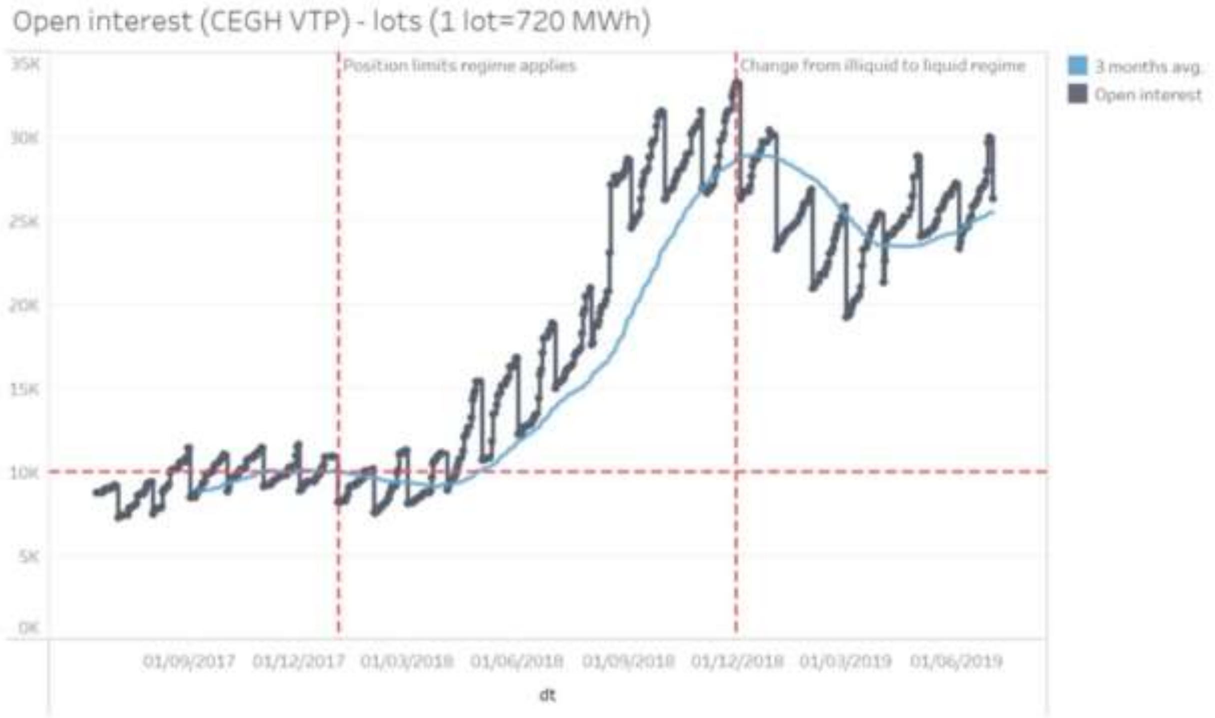

Figure 4 – Impact of slow pace with which the EEX Romanian Base contract is being classified from illiquid to liquid

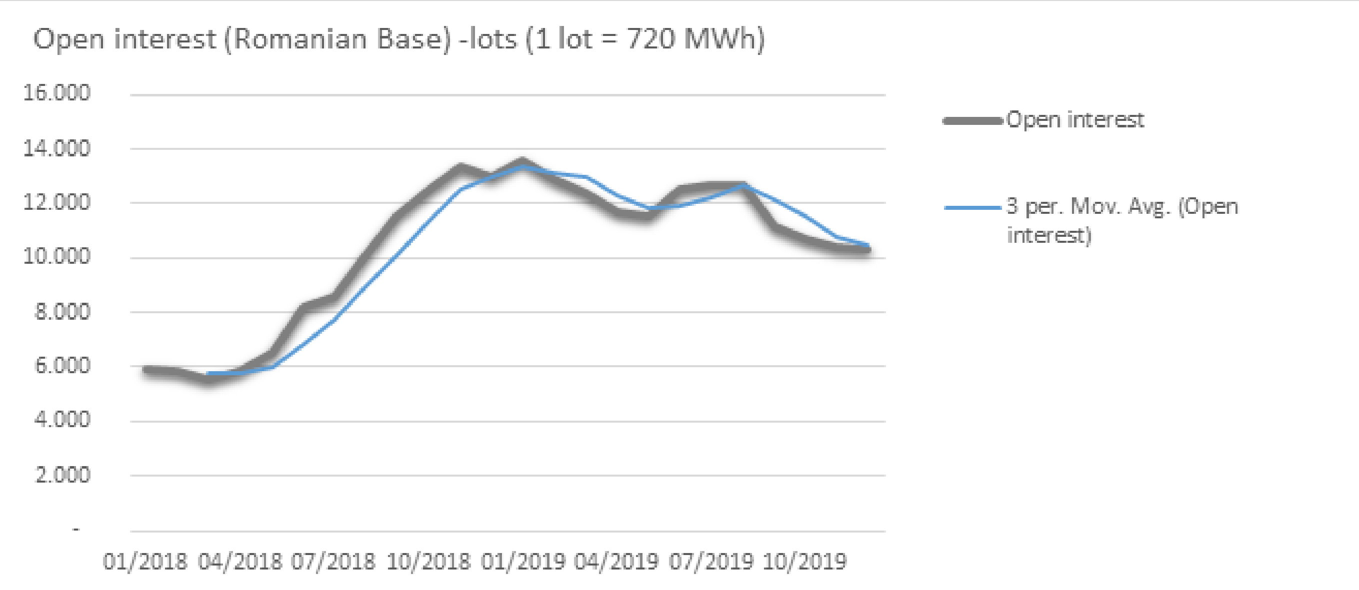

Figure 5 – Impact of the 2,500 lots limit in combination with the lack of hedging exemption possibilities for financial counterparties on the ZTP gas futures market

Figure 6 – Impact of the 2,500 lots limit in combination with the lack of hedging exemption possibilities for financial counterparties on the Czech VTP gas futures market

Figure 7 – The role of the ‘trade registration’ process in moving more trades onto regulated markets with the example of Spanish power futures