Deutsches Aktieninstitut

Position Limits under MiFID II: Retain well-proved Exemptions

Rules should adequately reflect risk management practices in non-financial companies

Reply to the Call for Evidence on Position Limits and Position Management in Commodity Derivatives, 5th July 2019

Introduction

Deutsches Aktieninstitut (identification number: 38064081304-25) represents the entire German economy interested in the capital markets. The about 200 members of Deutsches Aktieninstitut are listed corporations, banks, stock exchanges, investors and other important market participants. Deutsches Aktieninstitut keeps offices in Frankfurt, Brussels and in Berlin. We followed the legislation process regarding MiFID II/MiFIR very closely, expressing the view of non-financial companies using derivatives in their risk management.

Answers to selected Questions

Q1: In your view, what impact, if any, did the introduction of position limits have on the availability and liquidity of commodity derivative markets? What are in y-our views the main factors driving this development, e.g. the mere existence of a position limit and position reporting regime, some specific characteristics of the position limit regime or the level at which position limits are set? Please elaborate by differentiating per commodity asset class or contract where relevant and provide evidence to support your assessment.

In general, Deutsches Aktieninstitut notices a decrease of the number of suppliers in the commodity derivatives market. That tendency is triggered by the whole set of financial market regulation, which are positon limits part of. Therefore, rules regarding calculation methodologies should be clearly defined and unexpected rule changes should not increase uncertainty resulting in a withdrawal from further market participants from the market.

Q3: Do you consider that position limits contribute to the prevention of market abuse in commodity derivatives markets? Please elaborate by differentiating per conduct, per commodity asset classes or contract where relevant and provide evidence to support your assessment when available.

We consider the Market Abuse Regulation as a more effective and comprehensive tool to prevent market abuse. As regards the position limit regime and the prevention of market squeezes, it would be sufficient to set limits for the period right before expiry rather than covering the entire maturity curve.

Q11: In your view, how will EU commodity derivatives markets be impacted by the UK leaving the EU? What consequences do you expect from Brexit on the commodity derivatives regime under MiFID II?

As UK commodity markets represent a large share of the total EU market Deutsches Aktieninstitut believes that the UK market share should still be considered for the definition of the EU market sizes under the ancillary activity exemption (at least for a temporary period). Otherwise, the methodology of the threshold calculation needs to be amended to ensure that currently exempted non-financial companies would not become subject to the MiFID licensing requirements due to pure statistical effects. The above proposed changes should maintain the current scope of the exemption as the MiFID II licensing requirement would trigger considerable costs for the concerned firms and the wider real economy.

Q13: Would you see benefits in limiting the application of position limits to a more limited set of commodity derivatives? If so, to which ones and on which criteria?

In order to avoid unnecessary beaurocratic burdens the application of the position limit regime should be more focused, which would also better reflect a level-playing field with the US competitors. position limits should be limited on a set of important "core" or "benchmark" contracts and would, more importantly, not preventing the development of new and illiquid products. The other (non-significant) contracts would remain subject to the current position management of exchanges and, therefore, remain subject to appropriate position monitoring and management measures by exchanges.

Q16: In your view, would there be a need to review the MiFID II position limit exemptions? If so, please elaborate and explain which changes would be desirable.

As regards the exemption for derivatives used by non-financial companies to reduce risks related to the commercial activity the answer is clear: No, we do not see any need to review the exemption which has proved its practical feasibility in the daily business. Otherwise, the ability for corporate end-users to hedge fluctuations in commodity prices effectively would be hampered.

Nevertheless, the admistrative burden could be reduced. As some national competent authorities impose quantitative limits non-financial companies have to apply for a new hedging exemption every time they breach the quantitative limit. This could be e.g. the case if they have a larger hedging need because of their increased power production. In order to relieve companies and supervisory authorities a hedging exemption should be granted without the imposition of a quantitative limit and that such approach should be applied by all national competent authorities. The robustness of the regime and the supervisory capabilities of NCAs would be unaffected as NCAs can monitor the use of the exemption on the basis of the daily position reports.

Moreover, ESMA should give consideration to the proposal to also allow financial firms to benefit from an exemption for positions entered into to objectively reduce the risk of the position holder or their clients. Investment firms/banks, whilst dealing on own account, play a vital role in commodity market as they provide smaller commercial players access to derivative markets. Additionally, within some industrial energy groups, a MiFID II authorised investment firm acts as market facing entity for the Group and manages the positions (including the risk-reducing ones) of non-financial group entities.

Q18: Would you see benefits to review the approach for setting position limits for new and illiquid contracts? If so, what would you suggest?

We propose that the current de minimis limit for illiquid markets is increased to 5,000 lots to better accommodate the nature of fast growing contracts. Such an approach would ensure that (1) the development of contracts is not curbed by an overly restrictive limit once open interest grows closer to the 10,000 lots upper range of the illiquid markets category and (2) the overall framework becomes less dependent on unreasonably high levels of flexibility required from national competent authorities in terms of re-classifying markets and re-calibrating applicable limits on a near real-time basis.

For contracts between 10,000 lots and 20,000 lots or "less liquid contracts", we propose that the current derogation for the position limit should go up to 50 per cent and be transformed into a default approach from which derogations could be envisaged if needed.

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