European Securities and Markets Authority

Reply Form to the Consultation Paper

MiFID II review report on position limits and position management
Draft Technical Advice on weekly position reports

5 November 2019

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **8 January 2020.**

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'. Please follow the instructions given in the document 'Reply form for the consultation paper on "MiFID II review report on position limits and position management and draft technical advice on weekly position reports' also published on the ESMA website.

Instructions

In order to facilitate analysis of responses to the Consultation paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation paper in the present response form.

2. Please do not remove tags of the type <ESMA_QUESTION_WPR_1>. Your response to each question has to be framed by the two tags corresponding to the question.

3. If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.

4. When you have drafted your response, name your response form according to the following convention: ESMA_WPR_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_WPR_ABCD_RESPONSEFORM.

5. Upload the form containing your responses, in Word format, to ESMA's website (www.esma.europa.eu under the heading "Your input – Open consultations" → "Call for Evidence on Position limits and position management in commodities derivatives").

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading Legal Notice.

Who should read this paper

All interested stakeholders are invited to respond to this consultation paper. This consultation paper is primarily of interest to trading venues, investment firms and non-financial counterparties trading in commodity derivatives, but responses are also sought from any other market participant including trade associations, industry bodies and investors.

General information about respondent

Name of the company / organisation	Nasdaq
Activity	Regulated markets/Exchanges/Trading Systems
Are you representing an association?	☐
Country/Region	Europe

Introduction

Please make your introductory comments below, if any

<ESMA_COMMENT_WPR_1>

Nasdaq appreciates the opportunity to provide comments to the ESMA consultation paper on MiFID II review report on position limits and position management in commodity derivatives. We welcome ESMA's proposals in order to improve the current regime.

As argued in our response to ESMA's Call for evidence in this topic in July 2019, Nasdaq believes that the current position limit regime is creating barriers to competition between European exchanges listing liquid commodity derivatives with the same physical underlying. We therefore support to amend and broaden the definition of the "same contract" and to introduce the more pragmatic approach for setting the other month limits as proposed by ESMA under section 5.1.1 in the consultation paper. One of the key ambitions of the regulation is to ensure orderly pricing and settlement conditions, both for the derivative and the underlying commodity market. To achieve this, small differences in the derivatives contracts traded on different venues are not relevant. To remove barriers to competition, we believe same position limit should be set on all trading venues listing derivatives classified as liquid market with the same physical underlying.

Further, Nasdaq supports the move towards a reduced scope of commodity derivatives under the position limit regime.

Amending and broadening the definition of "same contract" and limiting the scope of commodity derivatives is urgently needed to allow exchanges in Europe to both compete in liquid markets as well as to develop the markets for new and illiquid contracts, to successfully compete globally.

<ESMA_COMMENT_WPR_1>

Questions

Part I

Q1 : Which option (Option 1 or Option 2) do you support for dealing with competing contracts? Please explain why. If you support Option 1, do you have any suggestions for amending the definition of “same contract” in Article 5(1) of RTS 21? If you support another alternative, please explain which one and why.

<ESMA_QUESTION_WPR_1>

Nasdaq welcomes ESMA’s proposals and supports both Option 1 and Option 2, as both are improving the current regime by ensuring a fair level playing field across trading venues. We believe there is an urgent need to limit the negative impact created by the current position limit regime and therefore recommend that Level 2 (and, accordingly, the ESMA Q&A) is amended immediately for both Option 1 and Option 2, while a more fundamental reform is dealt with as part of the Level 1 review.

We support Option 1 to broaden the “same contract” definition in Article 5 (1) of RTS 21. The current definition of “same contract” needs to be broadened since it may hinder competition between trading venues listing contracts that share the same underlying and characteristics. One of the key ambitions of the regulation is to ensure orderly pricing and settlement conditions, both for the derivative and the underlying commodity market. To achieve this purpose, small differences in the derivatives contracts traded on different venues are not relevant. The purpose of including EEOTC in the position limit regime is equally relevant for contracts listed on different trading venues.

We do not see a risk for “inappropriate netting of positions” in terms of position limits by broadening the definition of “same contract”. The term netting in this respect does not relate to financial positions on venue level (which will obviously have to be dealt with within the respective clearing venues), but to the overall positions in a market abuse perspective. In order to be efficient, the position limit regime should aim at covering as big a picture of the market as possible.

To give an example: Comparing the German power contracts listed by Nasdaq and the German power contracts listed by EEX, both contracts should in our opinion be defined as the “same contract”. Both contracts are valued on the same underlying commodity that is deliverable at the same location, with similar contractual conditions and it is having a highly correlated economic outcome. It is our understanding that market participants consider these contracts as fungible in real terms. Small differences in contractual specifications or risk management arrangements should not be barriers to declare these as “same contract”.

If a market participant has several open positions on EEX German power, the position limits regime should not in effect prevent him from opening a new position on Nasdaq German power. The current methodology pushes the liquidity to the largest exchange with the highest Open Interest (OI) where market participants have to continue to trade on the trading venue where they have the majority of their positions.

The current regime furthermore creates a risk that market participants may build undesirable one-way (buy or sell) positions in what is effectively the same contract, by trading on several venues without breaching the limit on one venue. This is contrary to the objective of the position limits regime. Potential market abuse will be more efficiently supervised when seeing these positions as a whole and not per trading venue. All contracts would remain subject to position monitoring and management by the trading venues and respective market surveillance procedures aimed at preventing market abuse.

Nasdaq also welcomes ESMA's proposal under Option 2 to remove competition barriers between exchanges and give trading flexibility for market participants to freely trade commodity derivatives on various exchanges. Nasdaq supports the approach where two or more trading venues listing commodity derivatives being deemed liquid, the other months limit of the most liquid market for these commodity derivatives should be applied identically to all competing contracts. This is an efficient mechanism to promote a level playing field between trading venues and an adequate choice to market participants. In our opinion this approach implies that competing contracts traded on different venues are considered "same contracts" since the open interest on the most liquid market should be used for setting other month's position limit for the competing contracts on other venues. Similar to remedies under Option 1, the impact on the definition of EEOTC contracts will have to be taken into consideration.

It should be stressed that Nasdaq presuppose that the different CA under such a pragmatic approach should operate under a firm European framework promoting a level playing field.

<ESMA_QUESTION_WPR_1>

Q2 : Do you agree that the C(6) carve-out creates an unlevel playing field across trading venues and should be reconsidered? If not, please explain why.

<ESMA_QUESTION_WPR_2>

The C(6) carve-out plays an important role in the structure and functioning of the continental European energy markets. Nasdaq therefore supports the continuation of the carve-out and believes a removal will have negative consequences for the continental market similar to those we have seen in the Nordic area.

The Nordic power market has for decades had a strong preference for trading on the regulated market, also before the implementation of C(6). There has not been any demand for OTF venues (requiring physical settlement) listing Nordic Power as the Nordic system price is a reference price and not a physical area price. The Nordic market consists of 12 price areas and in order to build a liquid market, there is a need to have a common Nordic system price as reference to secure a transparent and well-functioning liquid market with solid competition within the regulated market structure.

It is evident that the liquidity in the Nordic market has suffered significantly from the regulatory requirements. Since there are no active OTF venues with a liquid Nordic power offering, the C(6) carve-out hasn't been the reason for the drop in liquidity. The consequence of the overall increased regulatory requirements is what has been driving the Nordic market development towards "true" bilateral trading outside the regulated market.

After the introduction of MiFID II and EMIR, the liquidity in the Nordic regulated marked has decreased dramatically: Traded and cleared volumes have decreased from 1.432 TWh in 2016 to 952 TWh in 2018 and further down during 2019 where we expect total traded volumes to be around 800 TWh. At the same time, the level of bilateral trading outside the regulated framework has increased significantly, and we observe that several "semi-organized" trading venues have been established – fully outside the scope of MiFID II and also outside the scope of the C(6) carve out.

The dramatic consequences of the increased regulatory requirements are documented by the fact that more than 100 clearing members have terminated their membership with Nasdaq Clearing since 2016. These 100 former members are primarily fundamental players that have moved their trading to the non-regulated bilateral market. Further remaining fundamental players within the regulated market are reducing their long term hedging. They all argue that the cost for long term hedging and the burden of operating within the regulated framework has increased to a level where they benefit from trading bilateral instead.

The above development proves the importance of continuing the C(6) in order to prevent a reduction of fundamental players ability to hedge their long term needs. A removal will risk a move of the continental energy markets traded within the well-established REMIT carve-out structure towards the non-regulated bilateral market as seen in the Nordic area.

Nasdaq also takes this opportunity to highlight the need to consider adequate adjustments to the regulatory regime of MIFID, EMIR and CRD IV. If the liquidity continues to decrease in the Nordic power market, it will become even more disconnected from the physical demand and supply. This will result in continued reduction of liquidity, less transparency and lack of accurate and relevant long-term price signals used for long term hedging and investments, consequently impacting the true economy.

The current discussion relates to the scope of exemptions, but it is equally important to look into the main rules. It is a documented fact that the current regulatory requirements drive market players to venues outside the scope of the regulation – effectively reducing rather than increasing or preserving the role and effect of the regulation.

<ESMA_QUESTION_WPR_2>

Q3 : Do you agree that the position limit framework should not apply to securitised derivatives? If not, please explain why.

<ESMA_QUESTION_WPR_3>
Yes.
<ESMA_QUESTION_WPR_3>

Q4 : Which option do you support to address the negative impact of position limits on new and illiquid commodity derivatives: Option 1 or Option 2? Please explain why. If you support another alternative, please explain which one and why.

<ESMA_QUESTION_WPR_4>

Nasdaq supports Option 1. As described in our response to ESMA's earlier Call for evidence, the position limit regime should only apply to a limited set of critical contracts in order to avoid the negative impact of position limits on new and illiquid contracts. No limit should apply to new and illiquid contracts and this would protect the liquidity and competitiveness of EU commodity markets.
<ESMA_QUESTION_WPR_4>

Q5 : If you support Option 1 and would suggest different or additional criteria to determine whether a contract qualifies as a critical contract, please explain which ones.

<ESMA_QUESTION_WPR_5>
We do not support the other factors except the total combined open interest as proposed under Option 1. Nasdaq is of the opinion that such criteria must seek to support achievements of the objective of the position limits. Preamble 127 in MIFID II states that "(…) powers should be granted to competent authorities to establish limits, on the basis of a methodology determined by ESMA, on the positions any person can hold, at an aggregate group level, in a derivative contract in relation to a commodity at all times in order to prevent market abuse, including cornering the market, and to support orderly pricing and settlement conditions including the prevention of market distorting positions. Such limits should promote integrity of the market for the derivative and the underlying commodity (…)".

To achieve this objective, it is sufficient to define contracts as critical only where the size of individual positions may affect the price or settlement condition of the respective financial instrument, and where this financial instrument is relevant for the price formation in the underlying commodity. Nasdaq cannot see that the additional suggested factors (except open interest) ensure such achievement.
<ESMA_QUESTION_WPR_5>

Q6 : Which open interest and participant threshold would you suggest for qualifying a commodity derivative as a critical one?

<ESMA_QUESTION_WPR_6>
Please see answer under Q5.
However as described in our response to ESMA's earlier Call for evidence it is urgent to clarify a common open interest calculation methodology for all trading venues setting position limit across trading venues before thresholds of open interest are proposed. Nasdaq also responded and fully supported the intention of ESMA "Open Interest methodology Survey" in March 2019 to ensure an maintain equal application of the position limit regime. We do not argue that one methodology is more appropriate than the other, as we believe ESMA and the NCAs will ensure that the same open interest methodology is applied across all exchanges. This would allow all venues and market participants to operate in a fair competitive and transparent landscape where the position limit regime is not creating an unlevelled playing field.
<ESMA_QUESTION_WPR_6>

Q7 : Would you support a position limit exemption for financial counterparties under mandatory liquidity provision obligations? If not, please explain why.

<ESMA_QUESTION_WPR_7>
Yes.
<ESMA_QUESTION_WPR_7>

Q8 : Would you support introducing a hedging exemption for financial counterparties along the lines described above? If not, please explain why.

<ESMA_QUESTION_WPR_8>
Yes.
<ESMA_QUESTION_WPR_8>

Q9 : Do you agree with ESMA's proposals to amend Article 57(8)(b) of MiFID II and to introduce Level 2 measures on position management controls? If not, please explain why.

<ESMA_QUESTION_WPR_9>

Nasdaq has observed a divergent implementation of position management controls across trading venues in Europe, giving a divergent regulation of trading venues and market participants. Nasdaq therefore support ESMA's view that there would be value in providing further clarity on the expected scope and content of position management controls to support a more convergent implementation. It is crucial that national implementations are uniform across Europe in order to secure level playing fields among trading venues and market participants.

Nasdaq also support ESMA's recognition of flexibility in application to accommodate the characteristics of the different commodity derivatives traded on each venue.

Preamble 128 of MiFID II states that "All venues (..) should have in place appropriate position management controls (..) to mitigate the effects of large and dominant positions". Examples of such effects are not further communicated, but the supervisor has in its communication with Nasdaq referred to chapter 5 in the ESMA document "Questions and Answers on MiFID II and MiFIR commodity derivatives topics" and expressed that position management controls are something else than controls of position limits established by the supervisory authorities. Nasdaq has indeed been required to implement certain measures in relation to position management controls, in ways we understand are relatively strict compared to other jurisdictions.

Nasdaq is therefore of the opinion that a clarification of the purpose and objective of position management controls needs to be enshrined to secure a uniform understanding across Europe, and that this needs to be done before any introduction of level 2 measures.

<ESMA_QUESTION_WPR_9>

Part II

Q10 : Do you agree with the revised proposed minimum threshold level for the open interest criterion for the publication of weekly position reports? If not, please state your preferred alternative for the definition of this threshold and explain why.

<ESMA_QUESTION_WPR_10>
TYPE YOUR TEXT HERE
<ESMA_QUESTION_WPR_10>

Q11 : Do you have any comment on the current number of position holders required for the publication of weekly position reports?

<ESMA_QUESTION_WPR_11>
Nasdaq believes that the current number of position holders is sufficient.
<ESMA_QUESTION_WPR_11>