FINANCIAL CONDUCT AUTHORITY

Consultation Paper

CP23/27***

Reforming the commodity derivatives regulatory framework

December 2023

How to respond

We are asking for comments on this Consultation Paper (CP) by **16 February 2024**.

You can send them to us using the form on our website.

Or in writing to:

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When we make rules, we are required to publish an account of the representations we receive and how we have responded to them. We are also required to publish a list of the names of the respondents who made the representations, where those respondents have consent to the publication of their names. In your response, please indicate whether or not you consent to the publication of your name. For further information on confidentiality of responses, see the Disclaimer at the end of this CP.

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Foreword

The UK has some of the largest commodity derivatives markets in the world. These are a leading example of important UK services that have global relevance. For example, UK commodity derivatives markets provide benchmarks for the pricing of commodities internationally as well as serving the risk management needs of a wide range of market participants, including producers of commodities. In doing so they support the real economy and promote economic growth.

We have been conducting the Wholesale Markets Review (WMR) with the Treasury since 2021. As part of this, and consistent with our commitment in the WMR Consultation Response, we have carried out a comprehensive assessment of whether the existing regulatory framework for commodity derivatives markets is effective in ensuring fair, orderly and clean markets. We are committed to taking steps to strengthen the UK's position in wholesale markets, as outlined in our Business Plan for 2023/24, and this work supports that objective.

Over recent years commodity markets have experienced periods of extreme volatility, partly due to external political and economic factors. These events have shown how risks in these markets can be transmitted to other parts of the financial system and the speed by which this can happen.

Our proposals in this consultation paper seek to take the learnings from these periods of market instability to deliver greater resiliency during times of market stress. The proposals seek to improve the ability to identify risk through new requirements that result in additional data reporting, including of over-the-counter (OTC) data, and ensure that the system of position limits is sufficiently agile to respond to swiftly changing market events.

The WMR consultation proposed to make trading venues responsible for setting position limits, rather than these being set directly by us. Consistent with this, the Financial Services and Markets Act 2023 transfers the principal responsibility for setting position limits from the FCA to trading venues. We support this change and believe it will lead to stronger controls overall. Trading venues sit closest to trading activity and are able to see market dynamics in the moment. To ensure that trading venues determine and operate position limits consistently, we will set rules for how these limits should be determined and will proactively monitor and supervise how the trading venues are doing so. This shift of approach was supported by stakeholders in response to the recommendations under the WMR.

We know from previous crises how important it is for trading venues to be able to see data relating to their markets, including OTC positions, so that they can more effectively manage risk. This consultation proposes to strengthen trading venues' ability to see positions that may impact the orderly functioning of their markets through the reporting of data at a minimum under specific conditions, which we believe will be a significant step forward.

This consultation also aims to deliver fair and proportionate regulation by removing requirements that impose unnecessary burdens on firms, while placing a sharper focus on the market activity that poses the greatest risk to the real economy. Consistent with best international practices, we see an opportunity to reduce complexity by focusing on a set of critical derivative contracts – those that are most susceptible to market abuse or disorderly trading - and establishing a regime to enhance the reporting and oversight of them. The proposals in the paper take account of the IOSCO Principles for the Regulation and Supervision of Commodity Derivatives Markets updated in January 2023.

The proposed regime supports the wider supervisory work programme we are pursuing. This has already led to important initial steps to strengthen commodity derivative markets, such as through the introduction of more transparency for trades in some OTC commodity derivatives.

With this consultation, we aim to strengthen UK commodity derivatives markets so that they can continue to serve their users, in the UK and globally. We welcome feedback from all stakeholders to these set of proposals before we determine final rules – so that the new regime achieves the outcomes we intend.

Sarah Pritchard
(Executive Director, Financial Conduct Authority)

Chapter 1

Summary

Why we are consulting

1.1 The commodity derivatives regulatory regime aims to mitigate the risk that large positions, including those arising from abusive practices, can cause disorderly pricing or settlement conditions. This can harm not just participants in financial markets but users of commodity markets and the real economy.

1.2 This consultation is part of the Wholesale Markets Review (WMR), which is the review of UK wholesale financial markets. In line with our commitment in the WMR, we are amending our rules to ensure that they are proportionate to the benefits they deliver to market integrity. Chapter 2 provides an outline of the reforms set out in the WMR Consultation Response.

1.3 Our consultation sets out our proposals concerning the key pillars of the regime: position limits, the exemptions from those limits, position management controls, the reporting regime and the ancillary activities test.

1.4 This reform is an opportunity to ensure the UK's commodity derivatives markets remain resilient under a variety of market conditions by introducing new requirements to strengthen the supervision of those markets.

Who this applies to

1.5 The proposals in this CP apply to:

- trading venues in the UK which admit to trading commodity derivatives
- persons, including commercial users and financial firms, who trade commodity derivatives in the UK

1.6 Our proposals will also interest central counterparties (CCPs) dealing in commodity derivatives, trade associations and other persons, such as non-governmental organisations that have participated in public policy debates on the commodity derivatives regulatory regime and those that manage infrastructure through which futures contract deliveries are made.

What we want to change

1.7 The Financial Services and Markets Act (FSMA) 2023 gives us general rulemaking powers over Recognised Investment Exchanges (RIEs). It also gives us new rulemaking powers to establish how trading venues should set and apply position limits and what position management controls they should operate.

1.8 The Treasury has also amended the framework around the ancillary activities test (AAT) using the Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023 (Order 2023). Therefore, we are proposing consequential changes to our perimeter guidance.

1.9 The changes we are consulting on have been designed to support the objectives of the regime which advance our market integrity objective. The changes are:

- **Setting of position limits by trading venues** - consistent with the FSMA 2023, the principal responsibility for setting position limits is being transferred from the FCA to trading venues. Trading venues have the market proximity to set position limits effectively and to quickly change them if market conditions require. While trading venues will be responsible for setting the specific level of position limits, our proposed rules set out our expectations as to the factors they should have regard to. We will retain the power, under certain circumstances, to set position limits ourselves.
- **Applying position limits only to certain commodity derivatives contracts** – we are proposing to identify a set of 'critical' contracts for which disorderly trading would have the greatest impact on commodity markets and their users. We propose a regulatory framework under which trading venues will set position limits for this narrow set of critical contracts and also extend the application of the position limit regime to contracts that are sufficiently related to the critical contracts.
- **Enhanced position management controls and reporting** – we are enhancing our expectations as to the oversight and surveillance arrangements trading venues shall operate as part of their position management controls. Our proposed rules require trading venues to establish accountability thresholds and to have access to additional information, including information on positions held over-the-counter (OTC) by members and their clients.
- **Exemptions from position limits** – we are proposing new exemptions for liquidity providers and for financial firms dealing with non-financial firms that are hedging risks arising from their commercial activities. We are also strengthening our rules as to the arrangements that trading venues shall operate to satisfy themselves that the use of exemptions remains consistent with the operation of orderly markets.
- **Ancillary activities test (AAT)** – following changes made by the Treasury to the AAT, we propose new guidance on what constitutes ancillary activity.

An overview of the proposed regime

1.10 FSMA 2023 requires trading venues to set precise position limits for a narrower set of critical contracts determined by us. We are proposing new rules setting our regulatory expectations as to how position limits should be set by them. We are also introducing, as part of the process of granting exemptions from positions limits, the requirement for trading venues to consider whether limits to the size of exemptions, known as an 'exemption ceiling', should apply. An exemption ceiling is intended to mitigate the risk that these positions become too large, which may otherwise undermine the protections provided by the regime. Where a position goes above the exemption ceiling, it will result in additional reporting requirements.

1.11 We are also proposing to require trading venues to establish accountability thresholds for the same contracts to which position limits apply. Accountability thresholds are part of position management controls and support the early identification of risks before they crystallise. Where an accountability threshold is exceeded, it will also result in additional reporting requirements.

1.12 An important part of ensuring position management controls work effectively is the ability of trading venues to collect and assess information in order to assess whether large positions carry excessive risks, and what steps are needed to manage those risks. The information necessary to allow trading venues to make that assessment includes, at a minimum, position data in related OTC contracts and contracts traded on overseas trading venues. Additionally, trading venues will need to consider whether other data may also be required, for example, forward trades in the relevant underlying commodity.

1.13 Trading venues require different levels of data and monitoring capabilities across different markets depending on the features of the market, and will need to develop a risk-based approach to determine the level of reporting required to be able to monitor their markets effectively. For example, where OTC activity represents an important factor in a trading venue's assessment of risk to the orderliness of its market, we expect the trading venue will operate more systematic and regular reporting arrangements for OTC activity. At a minimum, we will expect trading venues to receive information on positions held OTC where it is considering the granting of exemptions, the appropriate action in response to breaches of accountability thresholds and, where applicable, exemption ceilings.

1.14 Where risks are identified, trading venues should take appropriate steps to address them, or flag, through information sharing, risk concerns where there is potential for such risks to spread more widely to relevant CCPs.

1.15 A period of adjustment will be required to ensure appropriate implementation of the changes proposed so that methodologies and frameworks, including systems and controls and processes can be developed or updated. During this time the current regime will continue to apply. We expect to provide a transitional period to allow time to make the necessary changes to comply with the regime, which we propose to be 1 year after we make the instruments following the publication of the policy statement.

1.16 Our PERG guidance will need to commence earlier to take account of the fact that the Treasury's Regulated Activities Order (RAO) changes enter into force on 1 January 2025.

1.17 We encourage market participants to respond to this consultation noting how long they might need to adjust to the proposals outlined, including any specific considerations that we should be aware of.

Q1: Taking into account the proposals outlined below, do you have any specific comments regarding implementation of the new regime? Please explain your answer.

Supervisory approach

1.18 We are proposing to transfer certain responsibilities to trading venues in line with the framework we set out in this CP. Key responsibilities for a trading venue will include:

- Developing methodologies and procedures that allow it to set and enforce position limits and accountability thresholds.
- Administering exemptions, including granting exemptions and applying, where applicable, exemption ceilings.
- Developing and maintaining a risk assessment framework and market risk analysis that underpins its market oversight and surveillance arrangements.

1.19 We will take a robust and proactive approach to our supervision of how the rules are being applied, this is particularly important during the initial implementation of the regime to ensure consistent application and to mitigate the risk of harm to end-users and our markets.

1.20 Under our proposed rules and guidance, we will require prior notification of the framework that a trading venue proposes to put in place and will expect trading venues to incorporate our feedback prior to implementation. This will apply to:

- The governance arrangements to be followed for adoption and continuing review of the proposed framework, including allocation of senior management responsibility, policies for managing conflicts, systems and controls, and board oversight.
- The methodology for setting position limits and accountability thresholds, including the identification of contracts related to critical contracts (together with decisions not to identify specific contracts), and which positions will not be eligible for netting. This must include the risk assessment framework developed to inform the design of the trading venue's position management controls. We expect that trading venues will develop different methodologies for different markets. Trading venues should consider and explain why particular factors are prioritised when setting a position limit or accountability threshold for each market.
- The detailed calibration of position limits and accountability thresholds set according to agreed methodologies.
- The proposed list of related contracts, related OTC contracts and related contracts traded on overseas trading venues.
- Policies and procedures relating to the granting of exemptions, including the approach to the setting of position ceilings.
- Policies and procedures related to position limit breaches including resolution and access to enforcement tools.
- Details of the risk assessment framework, including policies and procedures related to positions in excess of accountability thresholds and arrangements for additional reporting, that should detail the content, format and frequency of reporting of OTC positions related to critical contracts.
- Arrangements for the market-risk analysis. We expect trading venues to explain how its risk-based assessment results in the frequency of reporting of OTC positions related to critical contracts specified in its framework.
- Arrangements for the sharing of information with relevant CCPs.

1.21 We will also require notification whenever there is a significant proposed change to any of the above elements of a trading venue's framework.

1.22 We intend to consider position limits set in other jurisdictions for similar or equivalent contracts when reviewing the application of the rules.

1.23 We are also proposing to introduce several other notifications relating to the operation of a trading venue's framework. These include:

- An annual notification requirement evaluating the adequacy and effectiveness of accountability thresholds and informing us of the number of instances where thresholds have been exceeded, identification of the market participant(s) who caused the excess(es) and what steps were taken following the excess(es) to address identified risks.
- Notifications of each exemption granted, including where exemption ceilings have been applied.
- An annual report of all the exemptions granted and where exemption ceilings are imposed, a report of any breaches of those ceilings and the steps taken following the breach.
- Market risk analysis to be reported at a frequency agreed as part of our supervisory approach, but at least annually and when there is a significant change in market risk.

1.24 We will continue to exercise our information gathering powers as necessary, for example to understand how a particular decision was made. Where RIE's make notifications, we expect them to be made in accordance with REC 3.

1.25 Our aim is to ensure that we have access to the information we need to help us prioritise our interventions to support market integrity, while also ensuring an appropriate degree of consistency across trading venues. We recognise that we may need to act quickly in certain situations and we will reflect this in our supervisory approach, for example accepting after-the-fact notification should a trading venue need urgently to introduce a limit outside normal business hours.

1.26 We will factor in responses when developing our supervisory approach before the rules come into force.

Measuring success

1.27 The changes we propose should be assessed against the objectives of the regime, which enhance market integrity and resilience. We will monitor the operation of the commodity derivatives regulatory regime. As indicated in our Strategy 2022 to 2025, we will use a variety of metrics to assess whether our work is strengthening the UK's position in global wholesale markets.

1.28 To assess this, we will look at the frequency of breaches of position limits and accountability thresholds and the actions taken to address those breaches. We will consider the extent to which reporting requirements allow trading venues to operate their market surveillance arrangements as intended or whether further information is necessary. We will also consider whether implementation of the regulatory regime has impacted liquidity in relevant markets and, to the extent possible, the operation of relevant markets in times of market stress. Finally, we will consider whether the reform has reduced unnecessary costs and administrative burdens for firms.

Next steps

1.29 We want to know what you think of our proposals in this CP.

1.30 Please send your comments to us by 16 February 2024, using the options in the 'How to respond' section above. Unless you indicate that your response is confidential, we will not treat it as such.

1.31 Following consideration of responses, we will make the necessary amendments to the FCA Handbook rules and guidance.

Chapter 2

The wider context and the relationship to our objectives

Background

2.1 The UK Markets in Financial Instruments Directive II (UK MiFID II) is the collection of laws that regulate the buying, selling and organised trading of financial instruments. The rules are derived from European Union (EU) legislation that took effect in November 2007 and was revised in January 2018 (MiFID II). They were then amended in 2020 to address deficiencies arising as a result of the UK's withdrawal from the EU.

2.2 The 2009 G20 summit's agreement in Pittsburgh committed to improve the regulation, functioning and transparency of financial and commodity derivatives markets. The 2011 G20 summit in Cannes endorsed IOSCO's report 'Principles for the Regulation and Supervision of Commodity Derivatives Markets' which recommended that market regulators should be granted effective intervention powers to prevent market abuse, in particular position management powers and the power to set position limits. The G20 conclusions were in part in response to concerns regarding price volatility in certain commodity markets.

2.3 The commodity derivatives regulatory regime in MiFID II aims to address the G20 concerns. It reflects the key differences between commodity derivatives and other financial markets. When commodity derivative markets are disorderly, prices of derivatives in the delivery month may diverge from spot prices for the underlying commodity. This reduces the effectiveness of those markets to serve non-financial users and negatively affect the price of underlying physical commodities.

2.4 The pillars of the commodity derivatives regime are:

- **Position limits** – The maximum net position that any participant can assume in the market. They aim to mitigate the risk of an abusive squeeze and other abusive practices.
- **Exemptions** – The circumstances under which firms' positions are exempt from position limits. Currently an exemption is available to producers and consumers of commodities who use derivatives to hedge risks that arise from the future sale or purchase of the commodity.
- **Position management controls** – The set of arrangements and powers used by trading venues to minimise the risk that large positions may lead to disorderly trading and settlement conditions.
- **Position reporting** – The reporting regime that allows trading venues and regulators to identify the build-up of positions and monitor risks.
- **The ancillary activities test** – The test that provides an exemption from authorisation which non-financial firms, such as commercial producers, can benefit from under certain circumstances.

2.5 In July 2021, the Treasury published a Consultation, the WMR, with proposals to reform the UK's secondary markets framework. The Consultation Response, published in March 2022, stated that most respondents supported the following reforms:

- To revoke the requirement that position limits apply to all commodity derivatives traded on a trading venue and to economically equivalent OTC contracts.
- To require trading venues to set the levels of position limits for contracts specified by the FCA.
- To establish new exemptions from position limits for liquidity providers and for financial firms offering risk-mitigation services to non-financial clients.
- To modify the ancillary activities test, by revoking the current test and reintroducing a qualitative test, and to remove the related annual notification.

2.6 Recent market events have shown that more extreme volatility can heighten liquidity risks that arise when using derivatives to hedge physical commodity exposures. Where these risks are not adequately managed, they can transmit through the wider financial system, such as to CCPs, clearing members and bilateral counterparties through margin requirements. Recent market events have also highlighted that insufficient information about the extent and distribution of OTC positions can severely inhibit counterparties', clearing members' and/or the trading venue's ability to assess and act on these risks. This consultation is therefore an opportunity to strengthen market integrity by enhancing the regulatory framework.

2.7 Through our new rulemaking powers (as explained in paragraph 1.7) we propose to establish a framework setting out how trading venues should apply position limits and position management controls and where we apply more stringent requirements to a narrower set of critical contracts. Our consultation seeks to bring together the reforms set out in the WMR with changes that are necessary to address risks that may have contributed to recent market events. For this reason, we are proposing to strengthen the regime in some areas where the WMR did not recommend any change, such as on enhanced reporting and stronger position management controls.

2.8 We have also drawn insight from best international practices taking into account the updated 2023 IOSCO Principles for the Regulation and Supervision of Commodity Derivatives Markets ('IOSCO Principles' henceforth) and regimes in other jurisdictions, including the United States (US) and the EU. We have also held discussions and sought feedback from a wide range of external stakeholders during the development of our approach, taking into consideration their views.

2.9 While the aim of the regime is to support orderly pricing and settlement conditions and to mitigate the risk of market abuse, we considered it important for our reforms to also have regard to supporting the liquidity of commodity derivatives markets and to ensuring that they continue to serve commercial users who need to hedge their risks. During our engagement with market participants, they expressed support for this approach.

2.10 There are 2 instruments accompanying the consultation – a Handbook instrument comprising mainly changes to MAR 10 and consequential changes to a Handbook module, sourcebook and guides – and a standards instrument revoking and amending various technical standards. The combined effect of these changes is broadly to create a one-stop regulatory source of requirements. Our approach is to streamline the current complex structure of rules under a directive supported by delegated regulations, regulatory and implementing technical standards. We do so by housing in MAR 10 the various rules, directions, guidance and signposting to remaining Treasury legislation. This should improve ease of reference and identification of regulatory requirements for Handbook users when supported by updated perimeter guidance on the scope of legislation, aimed in particular at assisting the broad range of firms using commodity derivatives, as part of their non-financial business.

How it links to our objectives

Market integrity

2.11 Our proposed changes are primarily aimed at ensuring that the UK's commodity derivatives markets remain resilient and orderly under a variety of market conditions and firms can continue to operate in these markets with confidence.

2.12 Commodity derivatives markets can be susceptible to market abuse and disorderly trading. These risks can be exacerbated during times of market stress that can transmit through the wider financial system where not adequately managed. Strengthened reporting requirements are crucial to ensuring trading venues have effective market oversight arrangements in place. This information allows trading venues to identify risks and potential spillover effects from the underlying physical markets, related OTC markets and related derivatives traded on overseas trading venues. Further, accountability thresholds are a position management tool that provide trading venues with early warning of growing positions in relevant contracts so that the trading venue can understand whether risks are emerging and what actions should be taken to manage that risk.

2.13 We therefore expect that our proposed changes will protect and enhance the integrity of the UK financial system.

Consumer protection

2.14 Our work does not engage directly with the consumer protection objective. However, while developing our proposals we have had regard to ensuring that relevant markets continue to serve end users like commercial firms. Most users of these markets are financial services firms or firms involved in the extraction, production, distribution, consumption and trading of the underlying commodities rather than individuals. The users of these markets, and by extension consumers who are the end users of basic commodities, have an interest in UK commodity derivatives markets that are fair, transparent and operate with integrity. Our changes support this by permitting relevant position limits exemptions to ensure commercial users can hedge their risks, which in turn support liquidity provision, and ensuring trading venues are able to operate their position management controls effectively through strengthened disclosure requirements by firms.

Competition

2.15 The UK is home to global reference markets for certain commodities such as oil and non-ferrous metals. While the primary driver of our proposed reforms is not to advance our competition objective, our rules affect market participants globally and how they compete. In developing our proposals, we have had regard to ensuring that relevant markets continue to remain open and liquid. One of the changes proposed is to introduce exemptions from position limits for liquidity providers and for financial firms providing risk-mitigation services to non-financial firms hedging their commercial risk, which in times of market stress can become significantly important. Market liquidity supports competition and efficiency.

Secondary International Competitiveness and Growth Objective

2.16 FSMA 2023 introduced a secondary objective to facilitate the long-term growth and international competitiveness of the UK economy. As we work towards advancing our primary objectives, we must look at how our work affects the competitiveness and growth and advance them so far as reasonably possible.

2.17 We consider that our proposals support international competitiveness and growth of the UK in various ways:

- By strengthening the regulatory framework to make it more resilient (for example, applying more stringent requirements to a narrower set of critical contracts), we promote market stability and increase trust which helps increase participation in UK markets and liquidity in commodity derivatives.
- By removing obligations that don't promote market integrity in an effective way (for example, by removing the obligation to apply position limits to all commodity derivatives contracts traded on UK trading venues) we deliver proportionate regulation which seeks to ensure that regulatory costs are proportionate to the expected wider regulatory benefits. We expect this to make the UK commodity derivatives markets more attractive to participate in supporting liquidity and innovation, thereby improving the UK's competitiveness as a financial hub.
- By introducing obligations that help increase our operational efficiency, for example, by requiring UK trading venues to conduct and report to us market risk analysis, we strengthen our ability to effectively supervise our markets by identifying emerging risks which promote efficient and stable financial markets.

2.18 As mentioned earlier, when considering the design of the framework we have had regard to the IOSCO Principles and the regulatory regimes in other jurisdictions. We have also attempted to minimise undue costs – for example, allowing a period of familiarisation with changes to the regime before trading venues and firms are expected to operationalise them, setting the scope of position limits more narrowly and applying enhanced surveillance and transparency requirements to these contracts in a proportionate way.

Wider effects of this consultation

2.19 The UK has some of the largest commodity derivatives markets in the world that provide global benchmarks for the pricing of commodities.

2.20 A poorly designed commodity derivatives regulatory framework could expose trading venues and market participants to risks that are not adequately managed, including disorderly pricing or settlement conditions and therefore costs. This may be exacerbated in times of market stress where risks can transmit more widely to the financial system.

2.21 Further, where disorderly trading conditions exist, this could negatively affect the price of commodities that are widely used by the public, including potentially on a global level. A resilient commodity derivatives regulatory regime therefore supports the real economy and promotes economic growth.

2.22 Our Cost Benefit Analysis provides further evidence on the impact of our proposals on firms and consumers.

Equality and diversity considerations

2.23 We have considered the equality and diversity issues that may arise from the proposals in this CP.

2.24 Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010. But we will continue to consider the equality and diversity implications of the proposals during the consultation period and will revisit them when making the final rules.

2.25 In the meantime, we welcome your input to the consultation on this.

Chapter 3

Scope of the position limits regime

Introduction

3.1 Under MiFID II, position limits apply to all commodity derivatives traded on trading venues and OTC contracts that are lookalikes of those contracts, known as economically equivalent OTC contracts (or EEOTC).

3.2 EEOTC contracts were included to prevent circumvention of position limits and position reporting requirements. The criteria used to determine whether an OTC contract is economically equivalent to a contract traded on a trading venue have resulted in a very narrow definition of EEOTC. Therefore, in practice very few OTC contracts are included in the calculations of position limits and reported to us.

3.3 FSMA 2023 revokes the requirement that position limits must be applied to all commodity derivatives traded on a trading venue and to EEOTC contracts. Instead, it gives us the power to establish the scope of the position limits regime, ie, to specify the commodity derivatives to which limits must apply, with the exception of OTC contracts, for which it will not be possible to apply position limits. It also enables us to establish the framework outlining how trading venues should apply position limits. However, FSMA 2023 gives us the power to intervene directly by setting position limits where necessary for the purposes of advancing one or more of our operational objectives.

3.4 Under MiFID II, around 800 contracts traded on UK trading venues were subject to position limits. We effectively narrowed the scope of the regime to physically settled contracts and cash settled agricultural contracts through our supervisory statement in July 2021 ('our supervisory statement' henceforth).

3.5 The WMR Consultation Response highlighted that there was very large support for reducing the scope of the position limits regime. Many respondents felt that applying position limits to the instruments in scope of our supervisory statement was still too broad as not all physically settled and agricultural contracts pose risk to the pricing of the underlying commodity or to the settlement process. Some of the respondents also noted that there are enough safeguards already in place to manage risk in commodity derivatives positions, such as the use of position management controls, without the need for position limits.

3.6 In this chapter we cover the following:

- How we intend to identify critical contracts.
- How contracts that are closely related to the critical contract and traded on uk trading venues will be in scope of the position limits regime.
- The method of application of position limits – aggregation, netting and calculation at group level.
- How we intend to update the critical contract register to include new contracts.
- Which contracts we deem critical.

Analysis

Critical contracts

3.7 The MiFID II position limits regime has proved to be too broad in scope. It has caused market inefficiencies with little evidence of risk mitigation that the regime sought to address. Before our supervisory statement, the breadth of the scope of the regime was often cited as a source of compliance cost and complexity. Market participants also highlighted that the broad scope hindered the ability of liquidity providers to serve these markets efficiently. Article 15 of UK version of Commission Delegated Regulation (EU) No 2017/591 (referred to in the Handbook as MiFID RTS 21) provides for default position limits for new and illiquid contracts depending on the total combined open interest in spot and other months' contracts over a consecutive 3-month period. For newly listed contracts, this approach may have hindered the development of liquidity. Generally, due to the size and features of the contracts' market, little risk has been posed by these contracts to our markets. Applying position limits to new and illiquid contracts has therefore acted as a barrier to liquidity and price formation for limited benefit.

3.8 In our view, the scope of the position limits regime should be driven by the risks that those contracts pose to our markets. Consistent with the IOSCO Principles, the features of a commodity derivative contract, such as the type of settlement, any restrictions on the deliverable supply in the underlying commodity or the robustness of the price used for settlement, help to determine whether the contract is more susceptible to the risk of market abuse or disorderly trading conditions. The size of a commodity derivative contract, in terms of open positions and number of end users, are determinants of the impact that disorderly trading may cause to the wider market and its users. We therefore do not expect illiquid or new contracts at the point at which they are listed to be in scope of the position limits regime, unless there was a risk of circumventing the protections provided by regime by not including the contract in scope or where a contract is likely to be liquid from inception.

3.9 Physically delivered contracts differ from cash settled commodity contracts because of the link with the deliverable supply of the underlying physical commodity, which is finite. Because expiring futures contracts can be exchanged for the underlying physical commodity, the futures price should converge with the underlying commodity price. In the case of agricultural commodities, for example, in times of a shortage, increased supply may not be available for months or longer. The more difficult and costly it is to increase deliverable supply within the term of the contract (by expiry), the more susceptible the contract is to squeezes.

3.10 Everything else being equal, physically settled commodity derivatives are more susceptible to the risk of disorderly pricing or settlement conditions than cash settled commodity derivatives contracts. Where the deliverable supply of the underlying commodity is low relative to open interest, a derivative contract is particularly susceptible to manipulation as the contract approaches the expiry date. For example, a market participant may take a long position in a futures contract and buy the underlying physical commodity to influence the deliverable supply, driving up the price of both the commodity derivatives contract and of the underlying commodity at the delivery location for the relevant expiry date. Given its long position in the futures contract, the market participant would be able to profit from the higher price in the underlying commodity and the future. Any participant holding a short position in the futures contract would have to buy the underlying commodity at a higher price to be able to fulfil its future position obligations.

3.11 Further, all of the contracts currently in scope of the position limits regime, as a result of our supervisory statement, are physically delivered or capable of being physically delivered; this includes all agricultural derivative contracts and, in the case of Brent Crude Futures, exchange for physical (EFP) deliverable with the option to cash settle.

3.12 The payoff of a cash settled contract is determined by some price benchmark, which is constructed based on the trade price of the underlying commodity. For cash settled contracts there is a risk to orderly pricing conditions if a market participant holding the futures contract has the capacity to influence the price of the underlying commodity, such as where the underlying reference price or index is not robust enough. Markets more vulnerable to the risk of disorderly pricing or settlement conditions are when the derivative contract volume is much larger than the volume in the underlying commodity as futures contract position holders may trade the underlying asset in order to influence contract payoffs. The paper 'Competition and Manipulation in Derivative Contract Markets' by Anthony Lee Zhang (Dec 2018) shows that derivative contract markets can be much larger than underlying markets without increasing the risk of disorderly trading conditions provided the underlying market is sufficiently competitive.

3.13 The IOSCO Principles support the notion that the risk of disorderly pricing conditions for cash settled contracts may still be present where the price of a cash settled contract references more illiquid underlying physical commodities. For example, the price of a futures contract might be susceptible to manipulation where there are a low number of participants and a relatively small amount of trading in the market for the underlying commodity. Consideration should be given to the size and liquidity of the underlying physical market.

3.14 Position limits have historically applied to agricultural contracts because they are generally more volatile than other types of commodities and because of the potential risk posed to the pricing of the underlying commodity, including food.

3.15 Certain commodity derivative contracts are used as key benchmarks for pricing the underlying commodity market. For instance, ICE Brent Futures is widely used to price crude oil. As stated in ICE Brent Crude Oil FAQ '*..approximately two-thirds of the world's* *traded crude oil uses the Brent complex, which includes ICE Brent futures with its deep liquidity and far-reaching forward curve, as a price benchmark. Many national oil producers and other participants around the world price crude at a differential to Brent, depending on the crude grade'*. These types of contracts could therefore impact end users more broadly because of the potential risk posed to the pricing of the underlying commodity where abusive practices or disorderly trading occurs.

Related contracts and method of application of position limits

3.16 Currently, as stated on our website at Position limits for commodity derivative contracts, a single position limit applies to the principal contract and its related contracts such as mini, balance of the month (Balmo), mini-Balmo and others.

3.17 Minis, Balmos and mini-Balmos are contracts that share almost the same contract specifications as the primary contract. Minis are available in smaller lot sizes, known as miniature contracts of a primary contract. Balmos are contracts that can be entered into on any day of the spot month of the primary contract covering the remaining days of the current month. All are priced off the same underlying and provide participants with the flexibility to calibrate their hedging needs in terms of size and duration of the hedge.

3.18 A single limit applies to them, and positions are aggregated across the primary and the related contracts. We intend to maintain and expand this approach. The rational is that the application of position limits only to the primary contract would not reflect the overall position of a participant where related positions correspond closely in price/exposure and would expose the regime to circumvention. Additionally, under the current framework, Articles 3 and 4 of MiFID RTS 21 specify how firms should aggregate and net their positions as well as with positions held by different entities belonging to the same group (subject to certain conditions).

3.19 Under the US regime, the Commission Futures Trading Commission (CFTC) applies federal limits to 25 core referenced futures contracts and certain associated contracts. The associated contracts include any futures or option on futures (on a future-equivalent basis) that are directly or indirectly linked to the price of a core referenced futures contract, or that are directly or indirectly linked to the price of the same commodity underlying a core referenced futures contract (for delivery at the same location(s)). Economically equivalent swaps are also included in the concept of associated contracts under CFTC rules.

3.20 A robust position limits regime should consider the complex ecosystem of derivatives contracts that relate in price/exposure, which provide different ways for commercial users to hedge their risk and for financial firms to offset their risk when providing risk reduction services. The availability of contracts that are closely related to critical contracts, but outside the scope of position limits, would challenge the effectiveness of a regime. Firms might try to influence the pricing and settlement of the critical contract through positions taken in other related contracts.

3.21 It is therefore necessary to expand the scope of position limits to certain related contracts. Their inclusion aims to ensure that the protections provided by the regulatory regime are meaningful and not exposed to arbitrage.

3.22 When we discussed our intended approach with market participants, there was broad support for bringing within the regime appropriately defined related contracts. However, views varied about whether these contracts should be brought under the position limits regime or if they should only be considered for the purposes of position management arrangements when positions in the critical contract reach certain thresholds. We are unconvinced that inclusion of these contracts only through position management controls would work in practice, particularly as a market participant could use its positions in related contracts to conduct abusive practices before the trading venue would be aware of its accumulated positions, which may only be investigated if its position in the critical contract was above a certain threshold.

3.23 Our approach shares similarities with what applies in other jurisdictions. For example, as above, in the US the CFTC applies federal limits to 25 physically settled core referenced contracts and certain associated contracts.

3.24 The Markets in Financial Instruments Regulations 2017 (referred to in the Handbook as the 'MiFI Regulations') as amended by FSMA 2023 only provides for position limits to be applied in relation to commodity derivatives traded on UK trading venues, leaving the related OTC contracts or contracts traded on overseas trading venues to be addressed through position management. Our intention is to ensure trading venues have sufficient information about positions in these relevant markets to be able to identify, assess, and manage risks to their own markets. This is covered in more detail in Chapter 6.

Adding new contracts to the critical contract register

3.25 We have considered several approaches, including consulting each time we modify the list. However, where relevant commodity derivative markets are changing quickly and contracts need to be added to the register of critical contracts, it may be difficult to update the list in a timely manner if prior formal consultation is required. Consultation would require at least 6 months between when we identify the need to amend the list and when the list can be amended.

3.26 Using data trading venues provided us with (further detail provided below), we considered various conditions that could trigger close monitoring of a specific market with a view to including the contract in the register of critical contracts. We looked at absolute thresholds based on open interest, and lots traded as well as percentage changes in each, on a monthly and quarterly basis. We found that there was no clear or consistent way to apply a fixed threshold, even when separated by the type of underlying commodity (ie agricultural, metals, etc). This was also the case for percentage changes, particularly as some of the markets are inherently volatile and so periodic changes can be very high.

Proposals

Critical contracts

3.27 Our approach is to identify in our rules the set of contracts that we deem critical based on an assessment of the risks posed to our markets and to end users. Critical contracts are those for which:

- the risk from abusive practices or disorderly trading carries the greatest potential negative impact to relevant markets in a way that threatens the objectives of the regime, and
- position limits and the accompanying position management controls are effective arrangements to mitigate those risks.

3.28 We have identified criteria that we will have regard to when determining which contracts are critical. The criteria will be included in the Handbook to provide transparency as to how we establish the list of critical contracts on our register.

3.29 The criteria that we intend to use to establish the list of critical contracts must be sufficiently broad to allow us to calibrate the scope of the regime as we deem appropriate in light of the risks to our markets, which are different for different underlying commodities and for which the relative importance may change over time. We have therefore decided not to apply any fixed qualitative (eg, physically settled vs cash settled) or quantitative thresholds (eg size of the market by lots traded or open interest). Not all limbs of the following criteria need to be met for a commodity derivative contract to be considered critical, but the assessment of each criterion for the relevant contract will be considered holistically. The criteria we will have regard for are:

a. **The settlement method at expiry.** In line with the analysis above and the historical evidence, physically settled commodity derivatives are more susceptible to risk of disorderly pricing or settlement of positions than cash settled contracts.
b. **The size of the commodity derivative market compared to the underlying physical commodity and the robustness of the reference price used to settle contracts.** For cash settled contracts we will have regard to the size and liquidity of the underlying commodity market and the robustness of the data from which the price of the cash settled derivative contract is derived (for example, whether the settlement price accurately reflects prices in the underlying physical commodity market and the extent to which pricing information is publicly available and timely, commercially acceptable and the sample used to determine the settlement is sufficiently broad).
c. **The type of underlying and the impact on end-users.** In line with the analysis above and the need to minimise the risk that disorderly trading conditions or abusive practices in derivatives markets affect the underlying commodity markets and their users, we will have particular regard to agricultural derivatives and consider whether the derivative contract is a key benchmark for pricing the underlying commodity market.
d. **The size of the market.** Given our intention to apply position limits to contracts where the risk from disorderly trading carries the greatest potential negative impact

by threatening the objectives of the regime, we will have regard to the size and liquidity of the market by considering factors such as open interest, traded volumes and the number and variety of market participants.

Related contracts and method of application of position limits

3.30 We propose to require trading venues to identify related contracts according to the framework set out below, which will be part of our Handbook. Trading venues will include them within the application of relevant position limits accordingly. Trading venues should publish in a clear and accessible manner the list of related contracts for each critical contract traded on their markets.

3.31 Related contracts should include, as a minimum, options on critical and related contracts, mini, Balmo and mini-Balmo contracts, inter-contract spreads that include a critical contract and cash settled look-alike contracts that are linked to the critical contract in accordance with the following criteria:

a. **Any commodity derivative traded on a UK trading venue the settlement price of which is directly linked to the settlement price of a critical contract.** This criterion is aimed at including cash settled look-alike contracts, amongst others, when aggregating positions. For example, under the proposal that the Brent Crude Future is a critical contract, this criterion would likely bring in the Brent 1st Line Future as a related contract. Commodity derivatives listed on an overseas trading venue would not be included.
b. **Any commodity derivative traded on a UK trading venue that can result in a position or delivery obligation in the critical contract or another of its related contracts, either via exercise, settlement or expiration.** This criterion is aimed at including options and spread contracts that contain the critical contract or a related contract as the underlying of the option or as one of the legs of a spread contract, for example, if the Brent Crude future is a critical contract, the Brent position arising from a Brent-WTI spread contract should be aggregated with the position in the Brent Crude Future contract.
c. **Any commodity derivative traded on a UK trading venue the settlement price of which is indirectly linked to the settlement price of the critical contract.** This criterion is aimed at including contracts that have distinct but related features, such as the same underlying commodity, delivery location(s) or settlement types, but not necessarily all three. For example, the Dated Brent Future when compared to the Brent Crude Future.

3.32 In identifying related contracts, our rules set the expectation that trading venues should consider the objectives of the regime by assessing whether choosing not to identify the concerned contract as a related contract will risk undermining the protections provided by the regulatory regime and leave the risk of arbitrage exposed.

3.33 Position limits should apply to the participant's net positions in the critical contract and all related contracts, consistent with our current approach outlined in the analysis. As an example, when applying the position limit on the Brent Crude Future, market participants would aggregate their position on the Brent Crude Future with identified related contracts. Positions in related contracts could include those in the Brent 1st Line Future and those in the Dated Brent Future, any Brent-related leg components of a spread contract (eg Brent vs WTI) as well as delta-adjusted option positions on the critical and any related contracts. The aggregated position would then be assessed against the Brent Crude Future position limit.

3.34 Related contracts should be measured in units of the critical contract and aggregated and netted accordingly. However, the trading venue shall not permit the netting of positions in relation to certain contracts where such netting exacerbates the risk arising from large positions to the orderly pricing and settlement of transactions. For example, when reviewing trading venues' approach to netting we will have particular regard to positions resulting from trade-at-settlement (TAS) transactions. Those are transactions that give market participants the ability to enter an order to buy or sell an eligible futures contract during the course of the trading day at a price equal to the settlement price for that contract, or at a differential to the settlement price.

3.35 Where trading venues do not allow netting of positions in related contracts with positions in critical contracts, they should ensure this is clear to market participants and describe how positions should be aggregated. For example, a trading venue may allow TAS transactions (as in the example above) to be netted only with TAS positions. The trading venue should then describe how any resulting net TAS position should be aggregated, if at all, with other related positions for which the relevant position limit applies.

3.36 We are not changing our rules on how in-scope contracts shall be aggregated and netted with respect to parent undertakings. We are maintaining that where a parent undertaking can control the use of subsidiary positions, the parent undertaking should aggregate positions it holds directly with those held by its subsidiaries. Such aggregation should allow netting of long and short positions, taking account of any exceptions imposed by the trading venue in respect of certain types of related contracts. We are also maintaining that 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 and where the parent undertaking does not in any way influence the investment decisions in respect of those positions.

3.37 The treatment of positions that use an exemption are described in Chapter 5. For the purposes of applying position limits, exempt positions cannot be aggregated with non-exempt positions.

Adding new contracts to the critical contract register

3.38 We intend to ensure that the list of critical contracts remains relevant and up to date. We have opted for an approach that balances the need to factor feedback from market participants about the likely impact of our decisions with the need for us to be able to amend the list in an expedient and cost-effective way.

3.39 We propose that, once we have determined that a new contract is critical, we will provide market participants with a 45-day notice period, during which they may provide us with comments. Following that period, we will consider comments and finalise our decision. Where appropriate, the new contract will be added to the register as of the effective date included in our initial notice (or a different one depending on the feedback received during the notice period). Trading venues will have to establish position limits, in line with the framework set out in Chapter 4, within 30 days of a published decision to add a contract to the list or within a day of adding the critical contract to our register, whichever is later. Market participants will be expected to comply with the position limit set from the relevant effective date. Our approach would be in line with the one taken by other regulators in relation to certain specified products, eg by the CFTC in respect of determinations for inclusion of swaps in their derivatives trading obligation ('Made Available To Trade').

3.40 To be able to identify fast changing market conditions, we will use internal data, including what is available to us through the reporting of positions, and market intelligence gathered through our supervisory engagement with trading venues and other market participants.

3.41 Given our analysis and trading venues' market proximity, we consider it appropriate for trading venues to notify us when they believe a contract should be monitored more closely (before the need to assess its criticality) based on the risk of circumventing the regime, changes in volatility, liquidity, underlying characteristics of relevant markets (eg seasonality), and external factors that affect the fundamentals of the underlying commodity.

Analysis of contracts against criteria above

3.42 Through our discussions with external stakeholders, we found broad agreement with our approach and the contracts we were planning to consider and assess. Some stakeholders noted that trading venues would be best placed to help us understand if other contracts should be included in our analysis.

3.43 We conducted our analysis starting from the derivatives in scope of our supervisory statement, but we also included additional contracts that are neither physically settled nor based on agricultural commodities.

3.44 We used data provided by trading venues and publicly accessible information. The data covered monthly number of contracts traded, notional amounts and open interest for 2021, 2022 and year-to-May 2023 for all contracts in scope of our supervisory statement and the 10 most active (by number of contracts traded, notional amount and open interest) and most volatile (by standard deviation of the closing price) contracts outside of scope. The data provided to us also included the types of firms trading in each market as per classifications in MAR 10.4.4.

3.45 We propose to include all the derivatives in scope of our supervisory statement, which are all physically settled and are key benchmarks for the pricing of the underlying commodity, except: a) those that when assessed against the criteria above are not critical because of the relatively small size of their market; and b) those derivatives that in our view are likely to be deemed "related contracts" of another critical derivative.

3.46 Based on open interest and traded volumes (in lots) as a monthly average over the data period described, the following derivatives are very small and hence unlikely to pose material risks to our markets and to end users:

- London Metal Exchange (LME) Aluminium Alloy
- LME Cobalt, LME NASAAC
- HOS Permian WTI Storage Future
- O62-Heating Oil Outright - NYH ULSD Future
- O67-Heating Oil Outright - NYH ULSHO Future
- TFN-ICE Futures Europe Dutch TTF Natural Gas Futures
- UBL-UK Power Baseload Future (Gregorian)
- UPL-UK Power Peakload Future (Gregorian)

3.47 We considered other contracts that are not in scope of our supervisory statement but significant given their use and global reach.

3.48 We identified the T-West Texas Intermediate (WTI) Light Sweet Crude Futures as critical. Although cash settled, the derivative is a significant anchor contract with Permian WTI being its related, physically delivered contract. While we acknowledge that the market for the underlying physical commodity of the T-WTI Light Sweet Crude Future is liquid and therefore the risk of undue price influencing is relatively low given the market size, the T-WTI Light Sweet Crude Future is a key benchmark to price the underlying and related markets and so disorderly trading would have a high impact on all users, including end users of the underlying commodity. Similarly, while the Permian WTI contract is a physically delivered WTI contract, it is strongly correlated to the cash settled T-WTI Light Sweet Crude Future. Although our view is that position limits should apply to the Permian WTI Future, we consider it will likely be captured as a related contract as part of the same WTI ecosystem in line with the section in this CP on Related contracts. For this reason, we are proposing not to include it separately in the critical contract list.

3.49 We also didn't include the following contracts, which are of a size comparable to some of the largest contracts in the list of critical derivatives: the Dubai 1st Line Future and the Singapore Gasoil (Platts) Future. Notwithstanding the size of the derivative market, we have assessed that there is sufficient liquidity in the underlying commodity and for the 2 contracts the data used to determine the price of these contracts is reliable. It can therefore be concluded that these contracts are less susceptible to risk of disorderly pricing conditions. Further the Dubai 1st Line Future is a volume weighted average price of the main contract, Dubai Crude Future. Additionally, the Dubai 1st Line and the Dubai Crude Futures are quoted as Brent +/- spread and so the Dubai 1st Line Future (and the Dubai Crude Future) could potentially be captured as a related contract.

3.50 The Dated Brent contract is very liquid (ca 500k lots per month in 2022 and 630k lots per month year-to-May 2023) and has linkages with other Brent products (known as the Brent complex), comprising the physical commodity market, Forwards, Futures and Brent Swaps and Options. These markets are highly interconnected, all of which play a role in the price discovery process for crude oil as stated in An Anatomy of the Crude Oil Pricing System - Oxford Institute for Energy Studies, 2011. According to S&P Global, Brent Crude Future is a price reference for the underlying commodity. The Brent Crude Futures contract is known as the crude oil benchmark, however the Dated Brent Future is also an important benchmark for pricing crude oil and this is supported by the ICE Brent Crude factsheet that states approximately two-thirds of the world's traded crude oil uses the Brent complex as a price benchmark.

3.51 Since we already include Brent Crude Future in the critical list, we expect the Dated Brent Future to be deemed a related contract. Additionally, as Dated Brent Future is cash settled contract, it can be assessed that Dated Brent is less susceptible to risk of disorderly pricing or settlement conditions because there is sufficient liquidity in the underlying commodity and the data used to determine the price of the contract is reliable (source: Dated Brent Price Assessment Explained). For these reasons we are minded not to include Dated Brent in the critical list but would welcome market participant views.

3.52 The list of critical contracts which we are proposing to be subject to position limits is as per Table 1 below:

Table 1: Critical contracts

Contract Name	Underlying commodity	Settlement method	Open Interest in lots	Included in our supervisory statement
LME Aluminium	Metal	Physically settled	2021: 826k 2022: 686k Year-to-May'23: 709k	Yes
LME Copper	Metal	Physically settled	2021: 352k 2022: 293k Year-to-May'23: 301k	Yes
LME Lead	Metal	Physically settled	2021: 127k 2022: 112k Year-to-May'23: 119k	Yes
LME Nickel	Metal	Physically settled	2021: 246k 2022: 180k Year-to-May'23: 151k	Yes
LME Tin	Metal	Physically settled	2021: 14k 2022: 14k Year-to-May'23: 14k	Yes
LME Zinc	Metal	Physically settled	2021: 286k 2022: 239k Year-to-May'23: 224k	Yes

Contract Name	Underlying commodity	Settlement method	Open Interest in lots	Included in our supervisory statement
London Cocoa Futures	Agricultural	Physically settled	2021: 373k 2022: 409k Year-to-May'23: 479k	Yes
Robusta Coffee Futures	Agricultural	Physically settled	2021: 184k 2022: 165k Year-to-May'23: 164k	Yes
White Sugar Futures	Agricultural	Physically settled	2021: 78k 2022: 74k Year-to-May'23: 84k	Yes
UK Feed Wheat Futures	Agricultural	Physically settled	2021: 11k 2022: 12kYear-to-May'23: 10k	Yes
Low Sulphur Gasoil Futures	Energy	Physically settled	2021: 957k 2022: 563k Year-to-May'23: 604k	Yes
UK Natural Gas Futures	Energy	Physically settled	2021: 421k 2022: 247k Year-to-May'23: 202k	Yes
Brent Crude Futures	Energy	EFP, with option to cash settle	2021: 4.4mio 2022: 4.2mio Year-to-May'23: 4.6mio	Yes
T-West Texas Intermediate	Energy	Cash settled	2021: 911k 2022: 957k Year-to-May'23: 881k	No

<Trading venue responses to our data request sent July 2023, position data >

Q2: Do you agree with the approach outlined, including the criteria to assess the criticality of contracts? If not, please explain why.

Q3: Do you agree with the approach outlined above with respect to related contracts? If not, please explain why.

Q4: Are there any specific types or classes of contracts that should not be included in the related contract concept? If so, please explain why.

Q5: Do you agree with the proposed approach to update the list of critical contracts? If not, please explain why.

Q6: In notifying us of a particular market that requires closer monitoring, are there any other factors that trading venues should consider? If you think there are, please explain what the additional factors are and why they should be considered.

Q7: Do you agree with the list of critical contracts above? If not, please explain why.

Q8: Should any of the three cash settled contracts mentioned above (Dated Brent Future, Dubai 1st Line Future, Singapore Gasoil (Platts) Future) or the physically settled Permian WTI Future be added to the list of critical contracts? If yes, please explain why.

Q9: Taking account of our proposals on position management and the reporting of additional information, do you consider that the risks arising from positions held OTC are adequately dealt with despite the fact that position limits do not apply to OTC contracts? If not, please explain why.

Chapter 4

Setting position limits

Introduction

4.1 The IOSCO Principles recommend Market Authorities (which include regulators and operators of markets) to *'…have and use formal position management powers, including the power to set ex-ante position limits, particularly in the delivery month'*.

4.2 The Survey on the Implementation of the Principles, published in 2012, confirmed the widespread use of position limits as an essential tool to ensure the integrity of commodity derivatives markets. According to the Survey, almost all Market Authorities have the power to set position limits. While in some jurisdictions the power is held by the regulator, in most cases it is held by the operator of the market within each jurisdiction where the commodity derivative is listed.

4.3 FSMA 2023, removes the obligation for us to set the precise level of position limits and transfers this responsibility to trading venues in accordance with a framework set by us.

4.4 Trading venues are closer to relevant commodity derivative markets and have more timely access to data and market intelligence. This enables trading venues to make well-informed decisions about the appropriate levels at which position limits should be set and allows for timely adjustments to be made as market conditions change.

4.5 In addition to setting the framework for the establishment of position limits, we continue to have specific powers (given to us by MiFI Regulations) to intervene in markets, where necessary, allowing us to set position limits ourselves or direct persons in respect of their positions, such as to limit a person's ability to enter into a contract, restrict the size of a position a person may hold, or require the reduction of a position held.

4.6 Failure to set effective position limits and to oversee and manage positions can result in harmful impacts on our market. In this section we set out to the framework for setting position limits and the factors that should be considered as part of the methodology for setting position limits.

Analysis

4.7 Under the current framework, we are responsible for setting the position limits for all derivatives in scope of the regime in accordance with the methodology set in MiFID RTS 21 which clarifies the inputs that should be used to establish a position limit.

4.8 The core aspect of the position limits regime is how limits are set and which information is used to establish each limit. The current methodology differentiates between spot months and other months.

4.9 For spot months the methodology is based on the deliverable supply, ie the supply of the underlying commodity that can be delivered to settle the derivative, as the main criterion for establishing position limits. A baseline figure of 25% of the deliverable supply is the level at which a position limit should be set for a spot month, but adjustments can be made on the basis of specific factors specified in MiFID RTS 21. The adjustments can result in position limits as low as 5% and as high as 35% of the deliverable supply.

4.10 A similar approach, including the use of adjustment factors, applies to the establishment of position limits for months other than the spot month. For those contracts the baseline figure is 25% of the total open interest.

4.11 The adjustment factors include whether the contract to which the limit applies is new or illiquid, the maturity of the contract, the relationship between the open interest and the deliverable supply, the number of market participants and the characteristics of the underlying commodity market (including the infrastructures to deliver or store the commodity at a specified delivery point).

4.12 The differentiation between spot and other months is of particular relevance given the risks that position limits aim to mitigate. By being closest to expiry, the risk of abusive practices is higher for spot months than for other months because of the closer link between the price of the derivative contract and the price and the settlement of the underlying commodity. The current regime also accounts for the possibility of different position limits to apply within the spot month and/or other months period, with position limits decreasing as the derivative contract is closer to maturity.

4.13 The provision of a specific methodology by MiFID II, including the range of parameters for calculating the level of the position limits as a percentage of deliverable supply or of the open interest, was aimed to ensure harmonisation as to how position limits were set across different jurisdictions and commodity derivatives. To further strengthen the consistent application of the regime, the original RTS 21 established a system of notifications by competent authorities of the position limits set for the relevant contracts and the publication of an ESMA opinion about the compatibility of each position limit with the prescribed methodology.

4.14 While the regime has proved sufficiently flexible for some commodity derivatives, the application of fixed thresholds or parameters has restricted our ability to properly calibrate or disapply position limits for less liquid and new derivatives.

4.15 In the US each spot month limit is set at or below 25% of deliverable supply. We considered this approach and while it could provide a backstop against the risk of high position limits, in practice, the critical contracts subject to position limits cover a heterogeneous set of contracts and it would not be possible nor meaningful to set a threshold that is appropriate for all markets. For example, depending on the threshold set, a backstop could constitute an anchor for setting high position limits for some markets while for others it could constrain liquidity and the efficient functioning of the market as a means for managing risk.

4.16 Appropriate risk and governance arrangements around the framework covering allocation of senior management responsibility, conflicts management and arrangements for periodic review and challenge will provide additional protections against potentially high position limits.

Proposals

4.17 The proposals below cover our approach, whether position limits should apply to both spot months and the other months periods, the trading venues and participants in scope of the regime, rules around the framework, including when reviews of position limits should take place and governance arrangements, and the criteria that should be considered when developing the methodology for determining position limits.

Approach

4.18 In our view, the position limits methodology should allow trading venues to calibrate position limits according to the features of the market, the underlying commodity and the prevailing market conditions. This requires flexibility and the ability to apply discretion. A criteria-based approach will provide for this type of outcome and MiFID RTS 21 already sets out various factors that are relevant for calibrating position limits. It would also provide the framework setting out our regulatory expectations for how limits are set and form part of our supervisory approach.

4.19 We are not proposing to establish fixed baseline thresholds - or minimum and maximum levels - as percentages of deliverable supply or open interest. Instead, we will supervise the way trading venues set their limits having particular regard to their methodology, the input used, whether they adequately considered times of market stress when taking into consideration the parameters set to establish the limits and separately consider position limits set in other jurisdictions for similar or equivalent contracts.

4.20 The number and types of criteria for setting position limits should reflect the wide range of commodities and markets they apply to. While many of the criteria considered in MiFID RTS 21 remain relevant, we are proposing some changes based on the WMR consultation responses, market participant feedback and consideration of potential risks identified by recent market events.

4.21 Based on recent market events we consider it necessary for the criteria to clearly include an assessment of the liquidity of the market and ability of market participants to unwind their positions, including during times of market stress. This criterion takes the existing factors looking at the number of market participants (Article 19 of MiFID RTS 21) together with other relevant factors, such as traded volumes, to consider liquidity in the relevant market, but also market participants' ability to unwind their positions, including during times of market stress, in an orderly way. Additionally, we consider it necessary to assess the ability to make or take delivery, including during times of stress, together with the existing factor looking at the characteristics of the underlying market.

Spot and other months

4.22 Similarly to the current regime, we expect trading venues to apply different position limits to both spot months and other months (including to prompt dates for LME contracts). Trading venues shall consider whether multiple position limits should be set within the spot month period and/or the other months period respectively, where not doing so may risk undermining the protections provided by the regulatory regime and leave the risk of arbitrage exposed. For example, in the final days before expiry of a contract. This should also prevent the build-up of positions across the curve. Market participants' feedback generally supported a continuation of the current regime in this regard. Only 1 market participant suggested disapplying position limits to other month contracts, which they suggested could instead be replaced by relevant accountability thresholds under position management. We consider it important to link accountability thresholds to relevant position limits, which is discussed in Chapter 6.

Scope – trading venues and participants

4.23 Currently, the position limit regime applies to UK RIEs operating regulated markets, UK investment firms operating a Multilateral Trading Facility (MTF) or Organised Trading Facility (OTF) and UK branches of third country investment firms operating an MTF or an OTF providing markets in commodity derivatives. Commodity derivative position limits established by relevant trading venues apply regardless of the location of the person at the time of entering into the position and the location execution. We do not propose any changes in this regard and this approach is consistent with best international practices.

Framework for setting position limits

4.24 Our proposed rules require trading venues to ensure their position limits remain appropriate at all times. We set the expectation that position limits shall be reviewed at least annually and when there is a significant change in deliverable supply, open interest or any other change that significantly impacts the market. Further, position limits must be complied with at all times, including during the course of the day.

4.25 We propose to require trading venues to develop a methodology for setting position limits in line with the criteria, which will be prescribed in the Handbook, set out below. Trading venues should review their methodology for setting position limits periodically.

4.26 In developing its methodology for setting position limits, setting position limits themselves and any significant changes to either, a trading venue must have regard to the governance and systems and controls requirements that apply to it. For RIEs these are the requirements covered in REC 2.4A and 2.5 on the Management Body and Systems and Controls. For investment firms operating trading venues, it is the 'common platform requirements', including governance procedures, management of conflicts of interest, etc in SYSC and the MiFID Org Regulation. Currently similar requirements, albeit less detailed, apply to RIEs operating a regulated market.

4.27 A trading venue should notify us for agreement in advance of implementing its methodology, setting position limits, or making significant changes to either. Trading venues should provide us with relevant information about how the methodology has been developed and position limits set. The information to be provided should include the assessment against each of the criteria below, including as appropriate the impact of market stress, and consideration of the objectives of the regulatory regime. In exceptional circumstances, and where necessary to maintain fair and orderly markets, a trading venue may not be able to notify us before a position limit takes effect, but in such circumstances, we must be notified as soon as possible and be provided with any relevant supporting information.

4.28 The precise level of position limits set must be transparent, non-discriminatory, and published on a trading venue's website, and specify how they are applied; for example, at the level of the end client, regardless of their jurisdiction, bringing together positions in identified related contracts.

4.29 Trading venues should factor in views from users before setting each position limit to the extent possible. The trading venue must set out in which circumstances consulting with market participants will not be possible before a new position limit or change is implemented.

Methodology for setting position limits

4.30 We set out below the criteria that we are proposing trading venues should take into account when developing their position limit methodology and setting position limits:

a. **Deliverable supply in the underlying commodity** – Everything else being equal, the lower the deliverable supply the lower the position limit should be. Trading venues shall consider whether the deliverable supply in the underlying commodity can be restricted or controlled or if the level of deliverable supply is low relative to the amount required for orderly settlement. Trading venues shall also consider the extent to which the supply in the underlying commodity is also used as the deliverable supply for other commodity derivatives.
b. **Aggregate open interest and its relationship with the deliverable supply** – Trading venues shall consider whether the level of the open interest is large compared to the deliverable supply. Everything else being equal, the larger the open interest as a proportion of deliverable supply the lower the position limit should be.
c. **Maturity** – Trading venues shall establish different position limits for spot and other months. Where appropriate, multiple position limits may need to be set for the spot month period and other months period respectively. Everything else being equal: a) the position limit for the spot month should be lower than for other months (with a lower or equal position limit for shorter maturities); b) the larger the number of separate expiries for other months, the position limit for other months should be adjusted upwards.
d. **Volatility in relevant markets and ability to risk manage** – Trading venues shall consider the volatility of relevant markets, in the commodity derivative and in the underlying commodity, and the extent to which excessive volatility may impact the ability of market participants to unwind their positions. Everything else being equal, the higher the volatility, the lower the position limits should be.
e. **Liquidity in relevant markets** – Trading venues shall consider:

   - the aggregate traded volumes of all contracts in the commodity derivative, its underlying commodity, and in other commodity derivatives with the same underlying commodity, and
   - the number, type and size of the market participants and the use those market participants make of the contracts admitted to trading.

High and stable trading volumes with many market participants that are diverse in type may indicate more resilient markets. Everything else being equal, the more liquid and diverse the commodity derivative market, the higher the position limit.

f. **Ability to make or take delivery and characteristics of the underlying commodity market** – The trading venue should consider how the characteristics of the underlying physical market impact the functioning of the derivatives market. Trading venues should also consider the ease and speed of access which market participants have to the underlying commodity and the extent to which times of stress may impact the ability to make or take delivery. The assessment of the underlying commodity market should consider the following:

- whether there are restrictions on the delivery, storage or settlement of the commodity by assessing factors such as the characteristics of the underlying commodity (for example, physical properties, lifecycles and complexity of the delivery process), geopolitics, the environmental impact and the perishability of the deliverable commodity,
- the method of transportation and delivery of the physical commodity, including whether the commodity can be delivered to specified delivery points only and the capacity constraints of any specified delivery points,
- the structure, organisation and operation of the market, including the seasonality present in extractive and agricultural commodity markets whereby physical supply fluctuates over the calendar year,
- the number of market participants which provide specific services that enable the functioning of the underlying commodity market such as risk management, delivery, storage, or settlement services, and
- the size of positions held by market participants over a period of time relative to stock availability in the underlying commodity.

Q10: Do you agree with the approach and framework outlined above for setting position limits? If not, please explain why.

Q11: Do you agree with the criteria trading venues shall consider when developing their position limit setting methodology and when setting position limits? If not, please explain why.

Chapter 5

Exemptions from position limits

Introduction

5.1 All major commodity derivatives regulatory regimes recognise the special role that commercial firms play in the derivatives ecosystem by providing exemptions for certain positions held by non-financial firms. Non-financial firms are firms who are commercial users involved in the extraction, production, distribution, consumption and trading of an underlying commodity and who are not authorised to provide investment services, banking services, insurance services or operate or manage collective investment schemes. The IOSCO Principles also recognise that exemptions from position limits for hedgers are part of the regulatory framework for commodity derivatives.

5.2 Under UK MiFID II, non-financial firms can apply to be exempt from position limits when hedging against risks arising from their commercial activities. It supports participation in commodity derivatives markets by facilitating hedging by commercial users and in doing so it increases overall market liquidity. The current regime does not provide for any other exemption.

5.3 At the end of 2020 we said in a supervisory statement that we would not take supervisory or enforcement action for breaches of position limits where the breach arises from a position held by a liquidity provider to fulfil its obligations to provide liquidity on a trading venue. The purpose of the exemption is to mitigate an undue constraint on the ability of commercial users to access the liquidity they require to meet their risk management needs. We observed that the constraint was more pronounced in the market conditions prevailing during the coronavirus crisis.

5.4 In the WMR we proposed 2 new exemptions. The first was aimed at financial firms providing risk-mitigation services to non-financial firms hedging their commercial risk ('pass-through hedging exemption'). The second exemption was for liquidity providers, in effect codifying the approach taken in the aforementioned supervisory statement.

5.5 The US also offers hedging exemptions, predicated on the type of transaction being hedged rather than on a particular type of participant. Exemptions in the US are approved by exchanges and are reported to the CFTC monthly.

5.6 The CFTC allows a firm to benefit from a pass-through hedging exemption in the following circumstances, where:

- it enters into a position with a counterparty benefitting from a (bona fide) hedging exemption, or
- it off-sets the risk of the type of trade in the preceding point by entering into another position where it relies on representations made by the firm benefitting from a hedging exemption to validate the off-sets.

5.7 The EU introduced similar exemptions as part of 'quick fix' reforms to MiFID II which have applied since early 2022. The EU pass-through hedging exemption is available to financial firms within predominantly commercial groups to mitigate risks arising from the commercial activity of the group's non-financial entities. The EU liquidity provider exemption is available to both financial and non-financial firms who are fulfilling mandatory liquidity provision obligations (either required by regulation or through written agreement with a trading venue).

5.8 In this section we set out our general approach to the granting of exemptions from position limits and propose new exemptions from position limits for firms participating in commodity derivatives markets.

Analysis

5.9 As highlighted above, there are positions that may create risks even when originating from firms benefitting from an exemption. In addition to regulatory position limits, some trading venues set their own limits (eg expiry or delivery limits) and provide exemptions from those limits. In these cases, industry practices in place help prevent the accumulation of large positions by limiting the size of positions that can be exempt. A breach of that size limit results in certain disclosure requirements in line with the additional reporting section of Chapter 6 below. In certain cases, where a participant fails to comply with such requirements, the trading venue may take further action, for example, imposing a trading ban.

5.10 In line with the setting of position limits, we discussed with external stakeholders the transfer to trading venues of responsibility for the granting and monitoring of exemptions. There was broad agreement with this approach. This will allow trading venues to enforce position limits more effectively.

Hedging exemption

5.11 Under the current regime, non-financial firms are permitted to use the hedging exemption in respect of positions qualifying as reducing risks relating to their commercial activities. Article 7(1)(a) and (b) of MiFID RTS 21 provide specific criteria positions for determining when a commodity derivatives position qualifies for the exemption.

5.12 When a non-financial firm benefits from the hedging exemption, it must:

- describe in internal policies:
  - the types of commodity derivative contracts included in the portfolios and their eligibility criteria,
  - the link between the portfolio and the risks being mitigated, and the measures adopted to ensure that the positions concerning those contracts serve no other purpose,
  - and where they do, any position serving a different purpose can be clearly identified.

- be able to provide a sufficiently disaggregated view of the portfolios in terms of class of commodity derivative, underlying commodity, time horizon and any other relevant factors.

5.13 Article 8 of MiFiD RTS 21 sets out the information to be provided by the firm to us that demonstrates how the position reduces risks directly relating to its commercial activity. This information should allow us to determine whether the application should be granted in 21 calendar days.

5.14 There are no requirements about how often the use of the exemption should be reviewed, but the firm should notify us of any significant changes, which require a new application and relevant information to be submitted.

5.15 The rationale of the hedging exemption remains sound and we intend to maintain it. However, large positions, including those arising for the purpose of hedging commercial risks, may still pose risks to market integrity. This is particularly pertinent where trading venues don't have full visibility of those positions because a client may have its positions spread across multiple counterparties, including in related OTC markets, some of which may not be trading venue members. This risk was highlighted by the market events leading to the suspension of LME Nickel Futures in March 2022 where risks could not be fully assessed because of a lack of visibility.

5.16 As stated in Oliver Wyman's review of the Nickel market March 2022 commissioned by LME, 2 of the largest 10 short positions were exclusively in commodity derivatives traded on a trading venue, 5 had both OTC and on venue components, and 3 were exclusively OTC. All bar one of the OTC positions were spread between multiple members. Information is key to addressing these gaps.

Pass-through hedging exemption

5.17 There are limitations to the extent to which the existing hedging exemption supports liquidity in commodity derivatives markets. There are circumstances where non-financial firms may not be able to find a financial counterparty willing to enter into a commodity derivative because it would breach the applicable position limit. That is because while the non-financial firm can benefit from the hedging exemption, the financial firm cannot.

5.18 As set out in the WMR, we support the introduction of a new pass-through hedging exemption which complements access to the hedging exemption by allowing financial firms that facilitate hedging activity to do so without breaching a position limit. This will help remove barriers that may prevent a financial firm from being able to facilitate hedging activity by a non-financial firm, which in turn supports the provision of liquidity to the market. Restrictions on market participants' ability to provide liquidity can exacerbate risks during times of market stress.

5.19 In respect of the pass-through hedging exemption, the feedback we received from trade associations was for an approach in line with the US to allow for off-sets to be included.

Liquidity provider exemption

5.20 Given the business model of most liquidity providers involves short-term risk-taking and strict risk management, such activity should not normally result in large positions. However, liquidity providers may still risk breaching position limits in less liquid and/or in volatile market conditions. We received general support from market participants and their trade associations for an exemption for liquidity providers.

5.21 However, some proposed an exemption more loosely based on liquidity provision, including when there is no formal agreement in place and for firms facing clients with speculative positions (eg hedge funds), stating the positions are those of the client and not those of the firm. In our view, these scenarios are less related to formal liquidity provision and hence less justified. It would also be very difficult to evidence compliance with our rules.

Proposals

Approach to granting exemptions

5.22 We propose that trading venues be responsible for the granting and ongoing monitoring of exemptions. As with the position limits framework, to ensure appropriate organisational requirements govern the exemption arrangements, trading venues shall have regard to their governance and system controls requirements in the Recognition Requirements Regulations (RRRs) where they are an RIE and the common platform requirements in SYSC and the MiFID Org Regulation where they are operated by an investment firm.

5.23 Under our proposed rules, firms that intend to use an exemption must make an application to the trading venue and provide the information required by each type of exemption and specified under the trading venues' rules.

5.24 Once the trading venue has deemed an application complete, its rules should specify the time needed to make a decision and respond. The market participant must notify the trading venue if there is a significant change to any of the information it has provided, and the trading venue must reassess whether the exemption should continue to apply or be withdrawn.

5.25 Our proposed rules set out the different parameters on which exemptions can be granted, depending on the type of exemption. The availability of each exemption shall be assessed as soon as there is a material change in those parameters and on a regular basis but at least once a year.

5.26 We propose to require trading venues to consider establishing a limit on the size of a participant's exempt positions, known as an exemption ceiling. The purpose of a ceiling is to ensure that high regulatory expectations apply to the granting of exemptions by trading venues and that there is adequate monitoring of positions benefitting from them. The ceiling would mitigate the risk of such positions becoming so large that they undermine the protections provided by the regime.

5.27 To determine the size of the exemption ceiling, trading venues should consider factors such as the participant's current and anticipated activity over the year ahead, their credit worthiness, risk management approach and experience. The trading venue should make clear in its rules how it will apply and determine exemption ceilings, including when the size of a ceiling may be amended.

5.28 Our proposed rules require that a market participant breaching its exemption ceiling would be subject to additional reporting requirements to the trading venue. These will cover related activity, including exposures that are relevant to the critical contract, which is discussed further in Chapter 6. Trading venues may take further steps following a breach, as necessary.

5.29 Trading venues should notify us of each exemption granted, including where exemption ceilings have been applied. Additionally, trading venues should provide us with an annual report of all the exemptions it has granted. Where trading venues impose exemption ceilings, the report must also include any breaches of those ceilings and the steps taken following the breach. In response to a request from us, trading venues should provide us with relevant information that enables us to understand how an exemption decision was made. As part of our supervisory approach, we intend to agree the arrangements for this reporting with trading venues to ensure requirements are not overly burdensome.

Q12: Do you agree with the approach to granting exemptions outlined above? If not, please explain why.

Hedging exemption

5.30 We propose to maintain the definition of positions qualifying as reducing risks related to commercial activities as per Article 7 and 8 of MiFID RTS 21. We consider the existing definition remains appropriate and we have not received feedback from market participants suggesting otherwise.

5.31 However, we propose changes aimed at ensuring that that the use of the hedging exemption is consistent with resilient and orderly markets. We propose that trading venues should only grant it where they satisfy themselves that the exempt positions can reasonably be managed, including to be able to unwind them in an orderly way during times of market stress where market liquidity may be constrained. To that end, a non-financial firm shall provide the trading venue with information about the relevant commodity derivative positions it holds, including in related OTC commodity derivatives, and those it intends to hold over the year ahead. Specifically, this condition should focus on the non-financial firm's ability to unwind its positions at their highest point anticipated over the year ahead (to take account of peaks in anticipated activity because of, for example, seasonality), in a way that does not impair orderly markets. We discuss the additional reporting requirements, including definition of related OTC commodity derivative contracts for these purposes in Chapter 6.

5.32 When granting the exemption, to assess the condition described above during times of market stress, trading venues may consider the use of historical market movements within a given lookback period and/or calibrating forward-looking hypothetical market movements. We are considering how trading venues may best assess this condition during times of market stress and welcome market participant views on considerations.

5.33 When considering an application for a hedging exemption, a trading venue should have a clear and concise overview of the commercial activities of the non-financial firm in respect of the relevant underlying commodity, the associated risks, and how commodity derivatives (for which an exemption is being requested) are utilised to mitigate those risks. The information provided should at a minimum include current and anticipated activity over the year ahead, which may reference information about the previous year's activity, and include:

a. The nature and value of the non-financial firm's commercial activities in the relevant physical commodity underlying the commodity derivative for which an exemption is required.
b. The nature and value of the non-financial firm's trading activities and positions in relevant commodity derivatives, including in related OTC commodity derivatives.
c. The nature and size of exposures and risks in the commodity which the non-financial firm has or expects to have because of its commercial activities and which are or would be mitigated using the commodity derivative.
d. How the non-financial firm's use of commodity derivatives directly reduces its exposure and risks in its commercial activities.
e. Any other information that a trading venue may require to assess the non-financial firm's ability to unwind its positions at their highest point anticipated over the year ahead, including during times of market stress, in a way that does not impair orderly markets.

Q13: **Do you agree with the approach to the hedging exemption outlined above and the information to be provided to evidence use of the exemption? If not, please explain why.**

Pass-through hedging exemption

5.34 We propose to introduce a pass-through hedging exemption. The exemption provides a similar relief to the one available under CFTC rules. We will allow trading venues to grant financial firms a pass-through hedging exemption when:

a. The financial firm enters into an OTC position with a non-financial firm which is conducting hedging activity and the financial firm offsets the OTC position by entering into an in-scope commodity derivative contract, or
b. The financial firm enters into an in-scope commodity derivative contract with a non-financial firm where the non-financial firm is using the hedging exemption.

5.35 In both scenarios above, the position in the in-scope commodity derivative contract would not count towards the financial firm's net position subject to position limits. In the scenario in point a, the financial firm will have to obtain a written representation from the non-financial firm that the OTC position they enter into, which is being off-set with an in-scope futures contract, qualifies as a valid hedge. The futures and OTC positions would be expected to be substantially related. For compliant US trades, industry have developed solutions, such as standardised agreements, which do not require trade-by-trade representation. We would permit a similar solution to be used here.

5.36 A financial firm's application should give a trading venue a clear and concise overview of the risk-mitigation services it provides in respect of the relevant underlying commodity to non-financial firms. The information provided should at a minimum include current and, where possible, anticipated activity over the year ahead, which may reference information about the previous year's activity, and include:

a. The nature and value of a financial firm's risk-mitigation services in the relevant commodity underlying the commodity derivative for which an exemption is required.
b. The nature and value of a financial firm's trading activity and positions in relevant commodity derivatives, including in related OTC commodity derivatives, that relate to providing risk-mitigation services.

Q14: Do you agree with the approach to the pass-through hedging exemption outlined above and the information to be provided to evidence use of the exemption? If not, please explain why.

Liquidity provider exemption

5.37 In line with the supervisory statement, we propose to introduce an exemption for firms providing liquidity in the market provided:

a. The position arises as part of the firm's obligation as a liquidity provider.
b. The obligations to provide liquidity should be clearly defined by the trading venue and relate to observable metrics of market quality (eg depth and tightness of the spread).
c. The position should not be held for longer than necessary to discharge those obligations as a liquidity provider and should be reduced as soon as reasonably possible but, in any case, sufficiently before the expiry of the contract.

5.38 The information provided should at a minimum include current and, where possible, anticipated activity over the year ahead, which may reference information about the previous year's activity.

Q15: Do you agree with the approach to the liquidity provider exemption outlined above and the information to be provided to evidence use of the exemption? If not, please explain why.

Chapter 6

Position management controls and reporting

Introduction

6.1 The IOSCO Principles recommend regulators and trading venues have position management powers to address disorderly markets in commodity derivatives and such controls are part of international best practices.

6.2 Trading venues operate a variety of arrangements aimed at preventing or mitigating the risk of disorderly markets. Some arrangements are used by trading venues for all financial instruments and include the power to impose price limits and the suspension of trading or the cancellation of trades. Other position management powers or controls, such as the power to impose position limits, reduce or terminate a position or to source additional information about positions held by members, are specifically aimed at maintaining orderly markets in commodity derivatives.

6.3 An accountability threshold is a specific type of position management control. It is set at a position size appropriately below a position limit and is used by trading venues to monitor the build-up of large positions on their markets. When an accountability threshold is breached, it triggers supervisory actions by trading venues. In some cases, the appropriate course of action is to gather additional information from the participant while letting it remain above the threshold; in others it is to require the participant to reduce the position.

6.4 While some trading venues operate accountability thresholds for certain commodity derivatives (in conjunction with other position management controls), there is no explicit requirement under the UK regulatory framework for them to be established.

6.5 The position reporting regime provides the essential information about positions held by market participants in the relevant commodity derivative. The reporting is provided by members or participants of trading venues to us on a regular basis. The reporting regime currently covers commodity derivatives traded on a trading venue and EEOTC contracts. FSMA 2023 has removed EEOTC contracts from the scope of position reporting and position limits.

6.6 The importance of having adequate information about positions in commodity derivatives is recognised by the IOSCO Principles. These recommend that market authorities should be able to obtain information on a routine and non-routine basis for regulated commodity derivatives markets as well as the power to obtain information on a market participant's positions in related OTC commodity derivatives and the underlying physical commodity markets.

6.7 In the WMR, we didn't propose to make changes to position management controls or position reporting requirements. Most respondents noted that they worked as intended and advised against amending the regime because it would impose costly implementation changes, especially in relation to position reporting.

6.8 The recent disruptions in certain commodity markets have highlighted the need to strengthen position management controls and to ensure that trading venues have access to additional information to be able to operate effective surveillance arrangements. This particularly true in respect of information on OTC positions.

6.9 In this section we review the operation of the existing position management controls and of position reporting. We propose changes aimed at strengthening the regulatory framework in light of the evidence from the operation of markets under stressed market conditions, including the events surrounding the suspension of LME Nickel Futures in March 2022.

6.10 We have identified 2 key reforms that we believe will improve market integrity and reduce the risk of disorderly markets.

- The first is to require trading venues to establish accountability thresholds. In our view, accountability thresholds would improve the operation of the position limits regime by providing early warning of the build-up of larger positions, enabling quicker interventions when positions become large.
- The second is to introduce enhanced reporting from firms to trading venues, including in relation to positions held by firms in related OTC derivatives and derivatives traded on overseas markets. To be effective, trading venues' position management controls need to factor in positions in related instruments that can affect the orderly operation of their markets.

6.11 We also discuss how trading venues will use data they receive to perform market risk analysis, the information sharing arrangements we consider should exist between trading venues and CCPs to help manage risk and whether we should consider any specific changes to certain requirements for public aggregated position reports.

Analysis

Position management controls

6.12 The current UK regime, as specified under MAR 10.3, requires a trading venue to operate position management controls. These include having the power, at a minimum, to:

- monitor the open interest positions of persons
- access information, including all relevant documentation, from persons about:
  - the size and purpose of a position or exposure entered into
  - any beneficial or underlying owners
  - any concert arrangements, and
  - any related assets or liabilities in the underlying market

- require a person to terminate or reduce a position, including taking appropriate action if the person does not comply
- require, where appropriate, a person to provide liquidity back into the market at an agreed price and volume on a temporary basis with the express intent of mitigating the effects of a large/dominant position.

6.13 While not specifically mandated, UK trading venues already operate a variety of arrangements as part of their positions management controls. The type and operation of those position management controls reflect the different markets they apply to.

6.14 ICE Futures Europe (IFEU) operates expiry and delivery limits. Expiry limits are limits that apply for a fixed number of days prior to the expiry of a contract. These limits prevent a participant from having a position larger than what is set by the trading venue unless an exemption is granted. Delivery limits are restrictions on how much a trader can take to physical delivery of contracts that are subsequently settled. They typically apply only to the final, position at expiry which must not exceed a specified quantity. Similarly to expiry limits, delivery limits can't be exceeded unless an exemption is granted. When a member breaches an expiry or a delivery limit, IFEU would collect additional information about the member or participants to determine whether an exemption should be granted or if the participant should reduce the position.

6.15 LME operates lending rules aimed at market participants holding dominant positions. Under LME's Lending Rules holders of a dominant position in LME contracts may be required to provide a certain amount of liquidity in contracts rolled forward to the cash date at a pre-determined price to ensure they cannot exert undue influence on the market price of a particular contract close to expiry and squeeze the market.

6.16 Accountability thresholds provide a flexible and effective position management tool. Introducing an obligation for trading venues to establish accountability thresholds would strengthen their monitoring capabilities and enable them to intervene more quickly before they crystallise.

6.17 For example, in its capacity as a CFTC's registered Foreign Board of Trade (FBOT), ICE Futures Europe is required to establish spot month and other months accountability limits for certain oil and refined product contracts that are part of the CFTC's list of associated referenced contracts. The accountability thresholds can apply differently within the spot month (eg ICE WTI has a threshold of 6,000 lots that applies at market close 2 trading days prior to the last trading day of the contract while a threshold of 5,000 lots applies at market close on the last 2 trading days).

6.18 LME operates accountability levels for all its physically settled metal contracts and across all tenors (prompts) available to trade. If a position exceeds the accountability level, the LME may require further information as to the nature and purpose of the position and may direct members not to accept further orders that increase the position or direct them to reduce their positions.

6.19 We discussed with market participants the introduction of accountability thresholds and whether they should apply to all commodity derivatives or only to critical contracts. There was broad support for their introduction and for focusing on critical contracts. One market participant also expressed concerns that accountability thresholds can change the behaviour of firms who may, for example, deal in other markets (on overseas trading venue or OTC) to remain below the relevant threshold and avoid supervisory actions or to provide additional reporting.

6.20 As mentioned under the position limits framework, 1 market participant suggested disapplying position limits to other months contracts and replacing them with accountability thresholds in line with the US approach to non-spot months for non-legacy contracts (legacy contracts are the 9 physically settled agricultural contracts that were previously subject to limits before the 2020 final rulemaking).

6.21 We consider it necessary for position limits to apply to both spot months and other months in line with existing rules and industry practices. Accountability thresholds are an effective position management tool when operated in conjunction with position limits as they provide an early checkpoint at which information about the risks of a growing position can be gathered and assessed. We believe that those benefits exist not only in spot months, but across the curve, given that the risks associated with a large position may include difficulty in the orderly liquidation of that position, which may present broader risks to market orderliness particularly at moments of heightened stress. The assessment of an accountability threshold breach may also reveal wider risk management concerns which it may be appropriate to flag to relevant CCPs.

Position reporting

6.22 Under existing rules, there are 2 types of reporting requirements in relation to positions in commodity derivatives:

- public weekly reports providing information about the aggregate positions held by different categories of firms for each commodity derivatives, and
- daily reports, provided to us and not made public, with positions held by each person, including by the members or participants of a trading venue.

6.23 The obligation to report positions under the first point above includes EEOTC contracts. While positions for contracts that are traded on trading venues are sent to trading venues before being sent to us, positions in EEOTC contracts are sent only to us. Very few OTC derivatives are deemed economically equivalent.

6.24 As noted, recent market events have highlighted that limited information about related OTC positions (which may be spread across multiple counterparties), can severely inhibit the trading venue's ability to assess large and concentrated positions and to act on the related risks. To properly administer position limits and position management controls, trading venues need more extensive data on OTC positions to assess risks. We have considered whether existing regulatory reporting requirements can achieve the outcomes intended. Under the UK European Markets Infrastructure Regulation (UK EMIR) requirements, all UK reporting counterparties must report derivatives transactions to trade repositories. We receive UK EMIR data. However, this data does not cater for the global nature of firms participating in these markets and there are carve outs and reporting exemptions that result in key physically settled OTC derivatives either falling out of a reporting requirement or being reportable to other authorities, for example certain physically settled energy derivatives traded on OTFs. Therefore, the information we receive through the current EMIR reporting regime does not provide sufficient information to address the risks identified. Further, trading venues, who are responsible for maintaining fair markets, do not receive this data.

6.25 MiFID transaction reporting covers UK investment firms who execute trades (within the meaning of execution of a transaction in Article 3 of the UK version of Commission Delegated Regulation (EU) 2017/590 (MiFID RTS 22) and UK trading venues in respect of trades executed on their trading venue where a counterparty is not a UK investment firm. Reportable financial instruments are those specified in Part 1 of Schedule 2 to the RAO which are tradeable on a UK or EU trading venue or where the underlying or in the case of baskets or indices, a constituent of the basket or index is a financial instrument tradeable on a UK or EU trading venue. OTC commodity derivatives are only in scope of transaction reporting if the reference data details are the same as instruments tradeable on a UK or EU trading venues. This data does not cover position data, nor would it cover the related OTC contracts that may fall within the definition proposed below.

6.26 Trading venues need timely access to a broader set of data, including OTC position data, to conduct their surveillance responsibilities. To avoid a similar outcome as that observed for the position reporting of EEOTC contracts, related OTC contracts will need to include contracts that are likely to correspond closely in price/exposure to critical contracts. For this purpose, we have considered the US definition of referenced contract and LME's definition of relevant OTC contract in its Appendix I OTC Booking Fee Policy.

6.27 In our view, the provision of data on OTC positions should be risk-sensitive to the features of the relevant commodity derivative market and/or participant. For some markets a risk-sensitive approach may require the provision of a broader and more regular set of data, for example, where the related OTC market is assessed as accounting for a large proportion of the market. For others, this more systematic approach may not be necessary where the features of the market indicate that the potential impact of OTC market activity is limited. However, we believe that data concerning related OTC positions would always be needed where a trading venue is exercising its discretion to grant a position limit exemption, and where a position is in excess of an accountability threshold or an exemption ceiling, where applicable. This approach also considers our secondary objective regarding international competitiveness and growth.

6.28 It was highlighted in the discussions we had with market participants that trading venues may require a broad range of information to investigate the risks prevalent in the critical contract arising from large positions. This not only includes OTC positions but also extends to data and information about physical market activity and valuations, futures positions on other trading venues and storage of the commodity underlying a critical contract. This information may differ depending on the contract, for example, for Brent, key information may include the cargo trading activity of traders with substantial futures positions but could also include trader specific information. The 4 categories of data flagged to us as potentially relevant to understanding the implications of large commodity derivative positions were:

- Forward (or 'cash') deals in an underlying commodity - size and concentration of physical holdings in the underlying commodity. Where a market participant is dominant in trades in the underlying commodity and has a substantial position in related futures, then the rationale for these trades becomes relevant.
- Trades reported by a Price Reporting Agency (PRA) that are used to settle a futures contract - any dominance of these physical market trades by 1 or 2 market participants would be a warning signal of potential issues.
- Relevant trades in related derivatives, including positions at other venues - the price is of interest, as it should be similar/related to that of the futures contract.
- Inventories, storage and infrastructure integrity at the locations where deliveries into the futures contract are made. Actual stock holdings by a participant or more general location-wide stock information can provide a helpful indicator of potential supply disruption. Additionally, the ownership, control and concentration of delivery locations should be periodically monitored.

6.29 As suggested in third point above, other relevant data might include contracts traded and held on overseas trading venues. Under the US regime, an FBOT applies limits to relevant contracts associated with the 25 physically settled core referenced futures contracts to which federal limits apply, which results in certain reporting requirements. We are not proposing to apply position limits to relevant overseas contracts, but we do consider that data relating to positions in these contracts should be part of the additional reporting requirements, which would result in a similar approach to the CFTC.

6.30 As noted in Chapter 3, supported by the IOSCO Principles and highlighted through industry feedback, the relative scale of the underlying commodity and relevant futures markets is a consideration in determining how easily misconduct in the physical market can affect the futures market. For example, if the physical commodity market is small and the futures market is large, misconduct in the physical market can more easily affect a large futures market; or if a major market participant collapses, the disruption can spread to the futures market. This concern is much less acute where the physical market is larger than the futures market. Separately, where the value of the relevant futures contract is not converging with the price of the underlying commodity as the future's expiry approaches, then the futures contract is no longer a reliable hedge of the underlying commodity, which may be an indicator of market distortion, such as the price of the futures unduly reflecting the distress of a large market participant trying urgently to exit a position.

6.31 Similarly, the scale of the OTC market and the relevant futures market is also an indicator of how easily risks can manifest and cause harm. For example, a less liquid futures market may be susceptible to more extreme volatility and price movements, exposing market participants and CCPs to greater liquidity risk, particularly where the market consists of smaller participants less able to absorb shocks. These may be relevant points for the trading venue to consider when requiring additional reporting.

6.32 The view was expressed to us that enquiries about delivery intentions as contracts approach expiry is more beneficial and less burdensome than a broad requirement to report related positions in OTC derivatives. Additionally, it was argued, trading venues should be able to request further information, including regarding any related OTC positions, where there are legitimate concerns about risks of disorderly markets, which may not be related to or result in positions above accountability thresholds. In our view, OTC position data is important to an understanding of the risks posed by a large position, though may also be combined with other information. Further, our approach does not preclude a trading venue from obtaining this data outside of certain conditions specified, including an accountability threshold breach – and, indeed, where a risk-based approach indicates a need for regular access to such data that will be our minimum expectation.

6.33 One market participant raised the point that many OTC market participants have no positions on regulated trading venues and would not be required to report, nor would those who have futures positions relating to trades executed on overseas trading venues. Many physical market participants (eg refiners) have a trading and supply arm that carries out their futures trades. The trading entity would then report no OTC positions at all, while the refinery would have no futures positions, and would not be caught by any reporting obligation. Although we understand this concern, we would welcome market participants' views on how this issue could be addressed, for example by applying additional reporting requirements at a group level rather than at entity level.

Proposals

Position management controls

6.34 We propose to amend our rules requiring trading venues to establish and monitor positions against accountability thresholds. Our proposed rules set out:

- The scope and method of application of accountability thresholds.
- The methodology for setting accountability thresholds and the supporting framework.
- The requirement to notify us.

Scope and method of application of accountability thresholds

6.35 We propose that accountability thresholds apply to all critical contracts and their related contracts. This is in line with our approach to the scope of position limits as those contracts are the ones most susceptible to the risk of disorderly pricing and settlement conditions. Accountability thresholds would support and complement the operation of position limits by ensuring the monitoring and investigation of larger positions and reducing the risk that position limits are breached.

6.36 Similar to position limits, our proposed rules on accountability thresholds require trading venues to establish different thresholds for spot and other months (ie where a position limit is set, an accountability threshold should apply). Trading venues shall also consider whether it is necessary to establish different thresholds within the spot month and/or other months depending on the features and risks of the relevant market.

6.37 As with position limits, trading venues shall not aggregate positions across separate accountability thresholds, eg positions should not be aggregated across different periods (spot or other months). Trading venues shall aggregate participants' positions in the critical contract with those in their related contracts in the same way as for position limits, however positions shall also include those that use an exemption from position limits.

Methodology for setting accountability thresholds

6.38 A trading venue should calibrate accountability thresholds to the specific features of the derivatives and commodity markets they apply to.

6.39 The accountability thresholds must be transparent and accessible to all participants. As per position limits, accountability thresholds should apply at the level of the end client.

6.40 A trading venue's methodology for setting accountability thresholds should have regard to the objectives of the regime and, at minimum, consider the following criteria:

- **a.** The relevant position limit, the factors determining that precise limit and the need to ensure positions can be investigated before risks crystallise.
- **b.** Whether the volume and any required remedial action of accountability threshold excesses indicates that the control is being effective in providing early warning of prospective position limit breaches and enabling action.
- **c.** Periods of market concentration in trading activity.

6.41 Once an accountability threshold has been exceeded, trading venues should consider the following factors as part of their investigation:

- **a.** Historic and anticipated position sizes and risk management capabilities at market participant level taking into account prior knowledge of the market participant and the information received through exemption applications, including anticipated activity and, where relevant, the participant's ability to unwind its positions at their highest point over the year ahead in a way that does not impair orderly markets.
- **b.** The extent and quality of the participant's engagement with the trading venue and response to inquiries.
- **c.** Where a contract is physically deliverable, the complexity of the delivery process relative to that participant's expertise in deliveries for that deliverable commodity contract.
- **d.** An assessment relative to the rest of the market, including peers of comparable type.

6.42 Trading venues will be expected to ensure that their accountability thresholds remain appropriate at all times. We are proposing to require trading venues to review them whenever there is a significant change to the relevant position limit or when there is a change that significantly impacts the criteria set out above. In any case they should be reviewed at least annually. As with the position limits, trading venues should review their methodology for setting accountability thresholds periodically and when establishing their framework for accountability thresholds, a trading venue that is an RIE shall have regard to its governance and systems and controls requirements in the RRRs and for investment firms operating a trading venue, the common platform requirements, including governance procedures and management of conflicts of interest.

6.43 Trading venue systems and controls should enable monitoring of participants' open positions and enable them to identify and follow-up on any position, including those using an exemption from position limits - as such, all positions using an exemption should include flags to identify the exemption being used.

Risk assessment framework

6.44 Trading venues will be required to develop and maintain a risk assessment framework that underpins oversight/surveillance arrangements. The circumstances in which a market participant will be required to clarify their trading intent and provide additional data reporting should be clearly set out. Additionally, following investigations, the actions a trading venue may take in line with existing MAR 10.3, such as to require a participant to reduce or liquidate its position – which may relate to positions subject to position limits, those using an exemption, and/or positions in related OTC contracts - should be clearly set out.

6.45 Finally, the steps a trading venue may take if a participant fails to comply with any instructions issued should be specified. Where necessary, trading venues may flag risk concerns to relevant CCPs, as discussed further below.

Notification

6.46 We are requiring a trading venue to notify us for agreement in advance of implementing its methodology and setting the levels of the accountability thresholds. We also require notification of subsequent material changes to either the methodology or the thresholds. In exceptional circumstances a trading venue may not be able to notify us in advance, but in such circumstances, we must be notified as soon as possible. Where necessary, a trading venue should provide us with relevant information about how the methodology has been developed and accountability thresholds set. The information to be provided should include an assessment against each of the relevant criteria in paragraph 6.40 and consideration of the objectives of the regulatory regime.

6.47 We also propose to introduce an annual notification requirement where trading venues evaluate the adequacy and effectiveness of their accountability thresholds and inform us of the number of instances where thresholds have been exceeded, identification of the market participant(s) who caused the excess(es) and what steps were taken following the excess(es) to address identified risks.

Q16: **Do you agree that trading venues should establish accountability thresholds for critical contracts?**

Q17: **Do you agree with the approach outlined above and the factors that should be considered as part of the trading venues' accountability threshold setting methodology? If not, please explain why.**

Position reporting

6.48 We propose to introduce an obligation for trading venues to receive from their members and their clients, up to and including the end client, additional reporting when certain conditions are met.

6.49 We are proposing a risk-based approach to additional reporting. In line with this approach, trading venues should consider as part of its arrangements for market risk analysis whether regular, systematic reporting requirements are necessary for certain markets to ensure it can effectively monitor the orderliness of those markets, including by reference to specific features of that market, such as the proportion of trading done OTC and the possible impact of that activity. This may consist, for example, of the submission of data according to a standardised template and at a pre-defined frequency, such as weekly.

6.50 Where a trading venue determines that such an approach is not necessary for effective market monitoring, we will require as a minimum that its arrangements enable additional reporting to be triggered according to the conditions set out in paragraph 6.52 below. We expect a trading venue's risk assessment framework to specify the level of reporting required to enable it to monitor its markets effectively (ie, for which additional reporting requirements apply), as determined by the assessment outlined above. This should be notified to us for agreement in advance of its implementation.

6.51 Our proposed rules set out the framework for the additional reporting requirement as follows:

- The set of conditions that result in the obligation to provide additional reporting.
- The information to be reported once the additional reporting requirement is triggered.
- The definitions of related OTC contracts and overseas contracts.

Conditions that trigger additional reporting

6.52 We propose the following minimum set of conditions that should trigger additional reporting to the trading venue:

a. When a participant's aggregated exempt position is equal to or larger than the relevant exemption ceiling for specified commodity derivatives contracts set by the trading venue.
b. When a participant's aggregated position, including exempt positions, in critical and related contracts is equal to or larger than the relevant accountability threshold.
c. As otherwise determined by the trading venue in its risk assessment framework to support its general monitoring of the orderliness of its markets for individual contracts, including by reference to specific features of that market.

6.53 Where additional reporting is triggered, the reporting should continue for a period specified by the trading venue which is appropriate to the risks posed by the position in the market or as long the person's position is above the relevant exemption ceiling or accountability threshold. The duration and frequency of the reporting shall be set by the trading venue.

Types of information 'additional reporting' covers

6.54 The additional reporting that a participant will be required to report to the trading venue should encompass the following information:

a. Position reporting in related OTC derivative contracts.
b. Position reporting in related contracts traded on overseas trading venues.

6.55 A trading venue's assessment of an accountability threshold breach should include any information capable of affecting the price or delivery of the contract, which may go beyond the above position information, for example, to actual transactions and information regarding storage, stock movement, cargo, or vessel movement activity.

6.56 Further, as part of its investigations into growing positions, trading venues should consider any market-specific risk factors that stem from the relative scale of the underlying commodity market and relevant futures market, the relative scale of the OTC market to the relevant futures market and whether the value of the relevant contract is converging with the price of the underlying commodity as the contract's expiry approaches.

6.57 We will expect a trading venue's rules to place a responsibility on members to put arrangements in place with clients that enables ready access to data at the client level. While recognising that there may be limitations with regards to the information that can be obtained in particular cases, for example, as a result of secrecy laws in certain jurisdictions, we expect all reasonable steps to be taken to comply with trading venue rules.

6.58 The trading venue may also require the following additional information and should determine whether these are necessary to assess the risks related to the large position concerned and where it might source that data from, including from the participant. The trading venue may need to support its investigations by obtaining data from other sources, for example in respect of point c below.

a. Forward trades in the relevant underlying commodity.
b. Trades that are used to settle a futures contract, such as trades reported by PRAs.
c. Inventories, storage and infrastructure integrity at the locations where deliveries into the relevant contract are made, including the ownership, control and concentration of delivery locations.

Definitions of related OTC derivatives and derivatives traded on overseas trading venues

6.59 Related OTC derivative contracts and related derivatives traded on overseas trading venues should follow the same principles as we have outlined in the section of this CP under Related contracts in Chapter 4.

6.60 Related OTC derivative contracts and overseas contracts should therefore capture:

a. Any OTC contract or derivative traded on overseas trading venue for which the settlement price references the settlement price of the critical contract (ie cash lookalike contracts).
b. Any OTC contract or derivative traded on an overseas trading venue contract that can result in a position or delivery obligation in the critical contract, its related contracts or in the same underlying as the critical contract, either via exercise, settlement or expiration.

6.61 As with related contracts, we propose to require trading venues to identify related OTC contracts and derivatives traded on overseas trading venues according to the proposal above. Trading venues should inform their participants in a clear and accessible way of the contracts that are in scope of additional reporting requirements so that relevant positions can be reported accordingly.

Q18: Do you agree with the set of conditions that result in the requirement to provide additional reporting? If not, please explain why.

Q19: Do you agree with the information to be reported once the additional reporting requirement is triggered? If not, please explain why.

Q20: Do you agree with the definitions of related OTC contracts and overseas contracts? If not, please explain why.

Q21: Do you consider that additional reporting requirements should apply at a group level rather than entity level for the reasons highlighted in paragraph 6.33 above? If not, please explain why.

Operational implications of additional reporting and market risk analysis

6.62 There are challenges to reporting related OTC derivative contracts in a clear and consistent way, which are less standardised than derivatives traded on trading venues. For more bespoke contracts reporting may only be achievable in the form of a letter confirming open positions. We discussed with market participants how OTC position data, given the added complexity, could be ingested by trading venues, and potentially sent to us, but the feedback was that it could not be without significant burden. Therefore, we do not propose to specify the format in which trading venues receive additional reporting data.

6.63 Additionally, because it would also not be possible for trading venues to send this data to us in a standardised and systematic way, we propose that trading venues be required to perform regular market risk analysis and report that analysis to us. The trading venue should use the additional reporting data it receives, including information gathered from exemption applications and other data or market intelligence it has access to, for example, from its CCP to develop the market risk analysis, which should:

a. Identify risks and potential spillover effects from the underlying physical markets, related OTC markets and related derivatives traded on overseas trading venues.
b. Analyse how those risks could impact contracts traded on their trading venue.
c. Set out how those risks are being managed.

6.64 Consistent with paragraph 6.49, as part of its arrangements for this market risk analysis and prior to implementation, we expect a trading venue to consider the frequency of additional reporting it requires to enable it to monitor its markets effectively. Also, as a minimum, trading venues should store all additional reporting data in an easy retrievable manner so that it can be retrieved to respond to any specific requests, for example, a request by us for information under s165 of FSMA 2000 and/or questions on the underlying data supporting the market-risk analysis.

6.65 The frequency at which this analysis should be reported to us should be agreed as part of our supervisory approach, but at least annually and when there is a significant change in market risk, taking into consideration factors such as size or concentration of positions, including of related markets, settlement or delivery dynamics and alignment with underlying markets.

Q22: Do you agree with the proposal for trading venues to develop a periodic market risk analysis report? If not, please explain why.

Arrangements between trading venues and CCPs

6.66 As we set out above, recent market events have highlighted that limited information about related OTC positions can act as a barrier to effective interventions. Such limitations may also be relevant to a CCPs ability to oversee counterparty and liquidity risks.

6.67 We propose to require trading venues to establish adequate information sharing arrangements with relevant CCPs. We note that in the case of LME and IFEU, the trading venue and CCP form part of the same group and that such arrangements should therefore be straightforward to establish. Where a trading venue identifies potential concerns regarding concentration risk or funding liquidity risk as part of the information it receives through the exemption process or the proposed additional reporting in this chapter, we would expect it to take further steps to address such risks (eg position reduction) and/or notify its CCP so that the CCP may use this information, in addition to their own information gathering, to take appropriate steps to manage those risks in line with existing requirements. The trading venue may share the underlying position information with the CCP to enable it to address the risk management concerns.

Commitment of Trader reporting

6.68 In their response to the WMR consultation, 2 market participants proposed the removal of the current MIFID II inclusion criteria for Commitment of Traders (CoT) reports, which require trading venues to make public weekly aggregate position reports once 20 or more open position holders exist in a given contract. In their view, while it is generally a helpful source of information for market participants, the reporting requirement results in trading venues publishing CoT reports for relatively niche contracts for which the trading data are of limited value to the wider market. Equally, they said for certain larger, more systemic contracts where the deliverable supply is very large, there are no equivalent position reporting requirements. Trading venues may sometimes decide to publish their own reports outside of MIFID II requirements if there is a clear benefit to publishing the relevant data.

6.69 It was suggested that trading venues are well placed to take a view on whether CoT reports across different contracts provide a useful data source to market participants and publish relevant reports accordingly. While we are not proposing any change at this stage, we welcome views on whether this approach should be taken forward.

6.70 There were suggestions during the EU's MiFIR/D review process for changes to the public reporting of aggregated positions. We would welcome views on whether we should consider other changes to public weekly aggregate position reports.

Q23: Do you agree that trading venues are best placed to determine for which contracts CoT reports should be published or do you have views on how the criteria should be amended? Please explain your answer.

Q24: Are there any other changes to the public reporting of aggregated positions that you consider appropriate? If yes, please explain the changes you propose and why they are necessary.

Chapter 7

Perimeter

Introduction

7.1 MiFID II provides an exemption, known as the ancillary activities exemption (AAE), from authorisation for firms deal in commodity derivatives, emission allowances or derivatives of those instruments.

7.2 Firms can use the exemption where, provided certain conditions are met, they carry out investment services or activities which are ancillary to their main business. The AAE is included in paragraph 1(k) in Part 1 of Schedule 3 to the RAO. The conditions that a firm must meet before it can assess whether its activities are ancillary to their main business are as follows:

- a firm does not execute orders on behalf of clients by dealing on own account unless the client is a client or supplier of the group's main business
- a firm does not use a high-frequency algorithmic trading technique
- the activities are individually and in aggregate ancillary to the main business of the group to which a firm belongs
- the main business of a firm's group is not the provision of investment services, services requiring authorisation as a bank, or acting as a market maker in commodity derivatives

7.3 Once a firm determines that it meets the above conditions, it can perform the AAT, following the requirements in the UK version of Commission Delegated Regulation 2017/592 (referred to in the Handbook as MiFID RTS 20). The AAT has 2 components, both of which need to be met for a firm's activities to be considered ancillary to the activities of their main group.

- **Market share test** - A firm's trading activity must be below thresholds of overall trading in the UK and European Economic Area (EEA) in each of 7 classes of commodity derivatives and in relation to emission allowances and emission allowance derivatives.
- **Main business test** - A firm's trading activity must be lower than 10% of the activities of its group in respect of trading activity or capital employed. There are derogations from the main business test for firms complying with a more onerous version of the market share test; one for firms whose activities are between 10% and 50% and another for firms from whose activities exceed 50%.

7.4 In the case of both above tests, intra-group transactions, hedging transactions and transactions entered into as part of an agreement to provide liquidity on a trading venue are excluded from the calculations. The AAT must be performed annually, in the first quarter of the year, based on the previous 3 years' data. A firm that concludes it can use the AAE must make an annual notification to us.

7.5 As part of Brexit preparations, Article 72J of the RAO provided a transitional regime where:

- A firm undertaking activity covered by the AAE that has made an application for authorisation during a calendar year remains exempt during that period until the application has been determined or withdrawn.
- A firm cannot perform the market share test of the AAT because relevant data is not publicly available from an official source. This exemption became increasingly important as we have not published any such data and when the EU stopped using the market share test ESMA also stopped publishing data on the overall size of the market for different asset classes.

7.6 On the latter point, in 2022 we made changes to our Perimeter Guidance Manual and MiFID RTS 20. These changes clarified that firms did not need to undertake the market share test and that where relying on the derogations from the main business test, as specified in Article 3(2) of RTS 20, firms could use historic data for the overall size of the market. We issued an additional clarifying statement in January 2023. This statement will continue to apply for the year ahead (2024-2025) following the Treasury's decision to put back the revocation of Article 72J of the RAO to 1 January 2025. This will enable firms to continue using the ancillary activities exemption for 2024-2025 where they were able to rely on the exemption for 2022-2023 based on trading relating to the last previous published information (2018 to 2020) and maintain the additional flexibility alternatively enabling firms to have regard to their daily trading activity of the previous 3 years (2021-2023) for the purposes of continuing to rely on the ancillary activities exemption.

7.7 Under the WMR reforms, the Treasury proposed to simplify the AAE rather than expand or narrow its application. In the WMR Consultation Response the Treasury suggested that revoking the current AAT, re-introducing the 'commodity dealer exemption' (ie the qualitative exemption that was available under the original MiFID) and removing the annual notification requirements would improve the operation of the regime.

7.8 In May 2023 the Treasury legislated to make changes to the AAE. The Order 2023 introduced 3 main changes:

- it removes the requirement for firms using the AAE to make an annual notification to us
- the references in the RAO to MiFID RTS 20 are removed with the intention that the AAT as formulated in that RTS should no longer apply
- it removes Article 72J

7.9 The Explanatory Memorandum of the Order 2023 refers to returning to a principles-based approach to the exemption as the reason for the changes described. The Order 2023 is due to come into effect at the start of 2025 to enable firms to prepare for the revised AAE.

7.10 The legislation does not reintroduce the commodity dealer exemption, Article 2(1)(k) of the original MiFID. The commodity dealer exemption was broader than the corresponding parts of the AAE in MiFID II. As well as exempting commercial firms trading commodity derivatives to manage the risks of their underlying business it also allowed a principal trading firm focused on trading commodity derivatives to be exempt from authorisation.

7.11 With the revocation of Article 72J of the RAO, a firm that fails the revised AAT can no longer rely on the transitional relief that Article 72J provided (first point of paragraph 7.5).

7.12 Post-Brexit, the EU simplified its test for the AAE replacing its version of RTS 20 with a new Commission delegated regulation. That change took place after the end of the transition period following the UK's withdrawal from the EU and therefore the new delegated regulation on the AAT was not onshored into UK law. The EU's revised AAT remains quantitative. The following summarises the tests in the EU's revised AAT used by different firms depending on their business model as follow:

- **Main business test** - A firm is exempt if it can show that either the speculative trading it does in commodity derivatives accounts for 50% or less of the trading in commodity derivatives of all other entities in the group or the capital employed in carrying out the speculative trading it does in commodity derivatives accounts for no more than 50% of the main business of the group.
- **De minimis test** - A firm is exempt if it can show that the OTC trading it does in cash-settled commodity derivatives contracts is below a €3 billion net outstanding notional exposure threshold (the 'de-minimis threshold').

7.13 The US and Switzerland also have quantitative approaches to determining whether commodity derivatives firms require authorisation and effectively work on a de minimis basis.

Analysis

7.14 The Treasury has provided for a qualitative test and the intention is that this should be supported by FCA guidance on how the legislation should be applied. In considering the guidance we have had extensive discussions with industry. In these discussions 3 main points have been raised by market participants, in particular by energy firms.

7.15 First, about the merits of using guidance rather than rules and the consequence for the degree of certainty about the operation of the AAE. Our task in relation to the AAE is to provide guidance. In our view a clearly set legislative provision together with guidance can provide firms with a reasonable degree of certainty for determining whether they can rely on the AAE.

7.16 Second, concerns were raised about the situation in which a firm's trading activity can no longer be regarded as ancillary under the terms of the test following the deletion of Article 72J. While Article 72J no longer serves its original purpose, Treasury is committed nevertheless, as stated in the Explanatory Memorandum for the Order 2023, to ensuring that we have the right powers to set any transitional provisions that may be necessary to deal with the situation in which a firm's trading activity can no longer be regarded as ancillary under the terms of the test, to preserve continuity and legal certainty. We also have scope to take account of compliance with the guidance in our supervisory approach.

7.17 Third, a very strong preference has been expressed for a quantitative AAT to be used to determine eligibility for the use of the AAE. This is because of a concern that the meaning of 'ancillary' is not sufficiently clear on its own and because of the potential consequences of carrying on activity without authorisation, for example contracts being rendered unenforceable. It was suggested we should adopt EU's test which would provide legal certainty and reduce the operational burden of performing 2 different tests.

7.18 It is not possible for us to replicate the EU's AAT in full through guidance. The guidance can set out the sorts of factors, including quantitative elements, that in our view a firm should take account of in seeking to rely on the AAE. In addition, the wording in the original MiFID and in the revised version both refer to activity being **ancillary to a firm's main business** (when considered on a group basis). The language does not suggest that because a firm carries out a relatively low level of trading that this should be considered as ancillary without consideration of the scale of the main business of the group. For this reason, and consistent with the approach our predecessor, the FSA, took to interpreting ancillary under the original MiFID, we do not think that the guidance can refer to a de minimis threshold in the absence of legislation or the ability to make rules to this effect.

7.19 Further, a relatively small number of firms rely on the de minimis threshold, whereas the exemption is one that is relied upon by hundreds of smaller firms – from various sectors – where removing the administrative and practical burden of no longer needing to notify or perform calculations is uncontroversial.

Proposals

7.20 We propose to provide guidance covering the following 2 elements:

- First, confirmation of our understanding of 'ancillary', that it is something 'related' and 'subordinate' to the main business of the group.
- Second, confirmation that firms can have regard to the trading and capital employed thresholds used in the EU delegated regulation to judge what is ancillary.

7.21 This approach seeks to take account of the points made to us in discussion with industry within the existing legislative framework. The perimeter guidance relates to the wording of the revised legislation, as it must, and sets out the regulator's view as to the scope of the exemption, including that firms can look to the trading and capital employed thresholds used in the EU delegated regulation to determine what is 'ancillary' for their individual purposes. In accordance with standard practice, where a firm acts in line with the guidance, we will proceed on the footing that it has complied with the aspects of the statutory requirements to which the guidance relates.

7.22 Despite the removal of the annual AAE notification we may still ask firms to provide information that would help us to understand the basis on which they take the view that they can rely on the AAE. We do not intend to ask firms to provide such information on a regular basis, but where we have a specific reason to understand why a firm takes the view that it can rely on the AAE.

7.23 If there are any amendments to the EU delegated regulation in the future, we will consider how our guidance may need to be updated.

7.24 While noting the concerns we have heard from market participants we would welcome views on the extent to which our proposal adequately addresses those concerns.

Q25: Do you agree with the proposed guidance on the AAT? If not, please explain why.

Q26: Do you have any other views on the points outlined above?

Annex 1

Questions in this paper

Q1: **Taking into account the proposals outlined below, do you have any specific comments regarding implementation of the new regime? Please explain your answer.**

Q2: **Do you agree with the approach outlined, including the criteria to assess the criticality of contracts? If not, please explain why.**

Q3: **Do you agree with the approach outlined above with respect to related contracts? If not, please explain why.**

Q4: **Are there any specific types or classes of contracts that should not be included in the related contract concept? If so, please explain why.**

Q5: **Do you agree with the proposed approach to update the list of critical contracts? If not, please explain why.**

Q6: **In notifying us of a particular market that requires closer monitoring, are there any other factors that trading venues should consider? If you think there are, please explain what the additional factors are and why they should be considered.**

Q7: **Do you agree with the list of critical contracts above? If not, please explain why.**

Q8: **Should any of the three cash settled contracts mentioned above (Dated Brent Future, Dubai 1st Line Future, Singapore Gasoil (Platts) Future) or the physically settled Permian WTI Future be added to the list of critical contracts? If yes, please explain why.**

Q9: **Taking account of our proposals on position management and the reporting of additional information, do you consider that the risks arising from positions held OTC are adequately dealt with despite the fact that position limits do not apply to OTC contracts? If not, please explain why.**

Q10: **Do you agree with the approach and framework outlined above for setting position limits? If not, please explain why.**

Q11: **Do you agree with the criteria trading venues shall consider when developing their position limit setting methodology and when setting position limits? If not, please explain why.**

Q12: **Do you agree with the approach to granting exemptions outlined above? If not, please explain why.**

Q13: **Do you agree with the approach to the hedging exemption outlined above and the information to be provided to evidence use of the exemption? If not, please explain why.**

Q14: **Do you agree with the approach to the pass-through hedging exemption outlined above and the information to be provided to evidence use of the exemption? If not, please explain why.**

Q15: **Do you agree with the approach to the liquidity provider exemption outlined above and the information to be provided to evidence use of the exemption? If not, please explain why.**

Q16: **Do you agree that trading venues should establish accountability thresholds for critical contracts?**

Q17: **Do you agree with the approach outlined above and the factors that should be considered as part of the trading venues' accountability threshold setting methodology? If not, please explain why.**

Q18: **Do you agree with the set of conditions that result in the requirement to provide additional reporting? If not, please explain why.**

Q19: **Do you agree with the information to be reported once the additional reporting requirement is triggered? If not, please explain why.**

Q20: **Do you agree with the definitions of related OTC contracts and overseas contracts? If not, please explain why.**

Q21: **Do you consider that additional reporting requirements should apply at a group level rather than entity level for the reasons highlighted in paragraph 6.33 above? If not, please explain why.**

Q22: **Do you agree with the proposal for trading venues to develop a periodic market risk analysis report? Please explain your answer.**

Q23: **Do you agree that trading venues are best placed to determine for which contracts CoT reports should be published or do you have views on how the criteria should be amended? Please explain your answer.**

Q24: **Are there any other changes to the public reporting of aggregated positions that you consider appropriate? If yes, please explain the changes you propose and why they are necessary.**

Q25: **Do you agree with the proposed guidance on the AAT? If not, please explain why.**

Q26: **Do you have any other views on the points outlined above?**

Annex 2

Cost Benefit Analysis

Introduction

1. The Financial Services and Markets Act (FSMA), as amended by the Financial Services Act 2012, requires us to publish a Cost Benefit Analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'. Section 138S(2)(f) imposes an obligation in relation to technical standards.

2. In this CBA, we assess the impact of the changes we are proposing in Chapters 3-6 of this CP. We provide monetary values for the impacts where possible to do so. When in our opinion, these are not reasonably practicable to estimate, we provide a statement of our opinion and an explanation of it.

3. We set out here our assessment of the costs and benefits of our proposals. The changes to the commodity derivatives regulatory regime encompass the following:

- establish a list of critical contracts which require commodity position limits
- transfer responsibility for setting limits to the trading venues (as per FSMA 2023) in line with the framework we set
- transfer responsibility for granting position limit exemptions to the trading venues
- establish 2 new position limit exemptions
- require trading venues to apply accountability thresholds to critical contracts
- related over-the-counter (OTC) contracts and related contracts traded on overseas trading venues should be reported under certain conditions (at a frequency to be determined by trading venues)

A brief description of the market

4. The UK is home to some of the largest commodity and commodity derivative markets in the world, and they play a key role in establishing prices globally. There are 2 relevant UK trading venues operating in the commodities derivatives market: the London Metal Exchange (LME) and ICE Futures Europe (IFEU). These venues offer the contracts that are in scope of position limits. There are 21 additional firms with permissions to act as trading venues in commodity derivatives, who may offer trading in other contracts. The trading activity in relation to commodity derivatives generated by these other firms is limited.

5. Consumers in this market consist of financial and non-financial participants. Financial participants engage in the market for a range of activities such as investing, arbitrage, speculation and market-making. They include financial institutions, investors and traders. Non-financial participants engage with the commodity derivatives market to

hedge the risks arising from their commercial business (for example, risks associated with the extraction or production of an underlying commodity). They include participants such as manufacturers and commodity producers.

6. LME and IFEU provide participants with markets for trading different types of commodity derivatives that enable hedging to mitigate risk and provide benchmarks for the pricing of commodities internationally. Trading venues' business models involve providing a marketplace to facilitate pricing, trading, administration and other services to market participants. These trading venues rely on charging fees for trading and clearing services. LME and ICE operate predominantly in different segments of the commodities derivatives market and so to a large extent are not direct competitors. LME offers contracts in non-ferrous and ferrous metals, platinum and palladium. In contrast, IFEU offers contracts in agricultural and soft commodities, energy and emissions.

7. Under the new regime the critical list covers 14 contracts – see Chapter 3. There were around 8,200 position holders in the 14 contracts in 2022. The majority of these position holders are from jurisdictions outside of the UK.

Problem and rationale for intervention

8. In this section we discuss the harms that our proposals are seeking to address and the underlying drivers (or market failures) that bring about these harms.

The harms

9. The commodity derivatives regulatory regime in MiFID II reflects the G20 concerns and fundamental differences between commodity derivatives and other financial markets. When commodity derivative markets are disorderly, prices of derivatives in the delivery month may diverge from spot prices for the underlying commodity. This reduces the effectiveness of those markets to serve non-financial users and negatively affects the price of underlying physical commodities.

10. The commodity derivatives regulatory regime aims to mitigate the risk that large positions, including those arising from abusive practices, can cause disorderly pricing or settlement conditions and the harms such disorderly trading conditions may result in.

11. However, over recent years commodity markets have experienced periods of extreme volatility, partly due to external political and economic factors, which have in turn raised questions about the effectiveness of the current regulatory regime. These events have shown how a trading venue's limited visibility of the risks to their markets can transpire and how such risks, particularly during market stress, can transmit through the wider financial system where they are not adequately managed, such as to Central Counterparties (CCPs), clearing members and bilateral counterparties. Large position holders may be unable to meet margin calls when prices move significantly, and these missed margin calls may put at risk the solvency of CCPs. Solvency pressure on a CCP could have material financial stability implications.

12. A key feature of commodity derivatives that increases the possibility of abusive practices is when contracts traded are strongly linked to the underlying physical

commodity. This is because trading in commodity derivatives can exceed the available supply that can be delivered to settle positions at expiry. A large position holder can influence the price of a commodity by building large positions in derivative contracts, and interfere with the orderly delivery of the commodity. For example, in 2010, 1 commodity derivative trading firm was able to take delivery of 7% of the world's annual cocoa supply, which enabled the holder to dominate the market and affect prices. If positions exceed the supply of an available commodity, there is a risk that supply is not available for those market participants that need it. While this may be on a temporary basis this may prevent production taking place.

13. Further, higher prices for a commodity might encourage greater production but without fundamental demand for this increased supply. This would result in marginal supply being produced that costs more to supply than 'true' price manufacturers, and ultimately consumers, are willing to pay for, resulting in costs to society by market inefficiencies. Subsequent rebalancing of excessive supply with demand is likely to cause volatility, which will both directly affect production or use of a commodity and further reduce participants' willingness to use commodity derivatives to manage risk for their business.

14. In addition, any dislocation in prices or supply issues may result in some participants reducing their use of relevant commodity derivatives markets due to a loss of confidence, which negatively impacts liquidity and further affects pricing. Participants may consider alternative markets, including other trading venues for their commodity derivatives trading, provided alternatives exist that provide the same or similar contracts. This may mean market participants are less readily able to hedge the costs of their business, and therefore less able to bear risks. This will lead them to cut production or increase prices of physical commodities affecting end consumers.

15. Therefore, disorderly pricing and settlement conditions can send incorrect signals to the real economy on the production and use of commodities and have real impacts on both the UK economy and the wider world economy.

The driver of harm

16. The fundamental driver of the aforementioned harms is due to large positions leading to disorderly pricing or settlement conditions. This can occur because position holders do not take into account the risk of disorderly trading conditions that may arise from taking large positions. They only consider their own expected profits or their need to hedge risks arising from their commercial business.

17. While the commodity derivatives regulatory regime aims to mitigate such risks from large positions through position management controls and powers used by trading venues to minimise the risks arising from large positions, these mitigation mechanisms rely on effective, accurate and timely information and market transparency. The information required to address this harm must allow trading venues to identify risks and potential spillover effects from the underlying physical markets, related OTC markets and related derivatives traded on overseas trading venues. Currently, trading venues' ability to manage positions effectively is impaired due to the lack of information, including OTC information, leading to information asymmetry. While the current regulatory framework supports the provision of position data, the OTC contracts reported are limited. This is because the criteria used to determine whether an OTC contract is 'economically equivalent' to a contract traded on a trading venue have resulted in a very narrow definition of economically equivalent OTC (EEOTC) contracts. Further this data is currently reported to us and not trading venues. To mitigate the risk of the harms described above, the information asymmetry between trading venues and position holders needs to be addressed through the provision of additional reporting requirements that include OTC position data.

Our proposed intervention

18. In this section we provide a high-level description of the proposed changes.

Scope of position limits

19. The new scope of position limits will focus on critical contracts as defined by the FCA. Physically settled derivatives are the main focus, and we will consider cash settled contracts where there is a higher risk of disorderly pricing conditions, based on specific criteria (see para 3.29 of this consultation paper). An effective position limit regime would not intend to hinder the growth of nascent contracts with a minimal risk of harm.

20. To avoid arbitrage opportunities, also included will be contracts which closely link to the critical contracts based on the criteria described in Chapter 3 known as related contracts. Trading venues will be expected to combine positions across the critical and related contracts when determining if a participant is above the position limit.

Framework for setting position limits

21. The responsibility for setting each precise limit is being transferred to trading venues as per FSMA 2023. Based on the criteria and framework defined and agreed by us in Chapter 4 the trading venues will determine the position limit applicable to each critical contract. For critical contracts trading venues will as minimum set spot and other months limit, with the expectation that they will set additional limits at other points across the curve where appropriate.

Exemptions from position limits

22. Based on responses from Wholesale Markets Review (WMR) we are proposing 2 new exemptions from position limits: (i) to financial firms offering risk-mitigation services to non-financial clients hedging their commercial risk ('pass-through hedging exemption') and (ii) to liquidity providers, including commercial firms providing liquidity but not captured by MiFID II incentive schemes.

23. Additionally, we are proposing a new risk management condition in respect of the hedging exemption and to transfer the responsibility of granting, monitoring and renewal of position limit exemptions from the FCA to the trading venues.

Position Management

24. Trading venues will be expected to impose accountability thresholds on spot and other months for any position limit that is applied. Accountability thresholds are required for all critical contracts. In the same way as for position limits, for position management trading venues and participants will need to incorporate related contracts in their overall position, including exempt positions.

25. Trading venues will be expected to have sufficient market surveillance and monitoring capabilities in place to detect concentration build-ups across the curve. Within this functionality, trading venues are expected to follow-up with participants where necessary and take measures to ensure large positions are not a threat to fair and orderly functioning of the markets.

Position Reporting

26. For position limits, EEOTC contracts have been removed from FSMA 2023 as too few positions were reported and the scope of the current reporting regime did not provide sufficient information. In order to properly administer the position limit and position management regimes, trading venues need more extensive data, including on related OTC positions to assess risks. Additional reporting requirements, including positions in related OTC contracts and contracts traded on overseas trading venues, apply with respect to critical contracts, under certain conditions (at a frequency to be determined by trading venues).

Perimeter

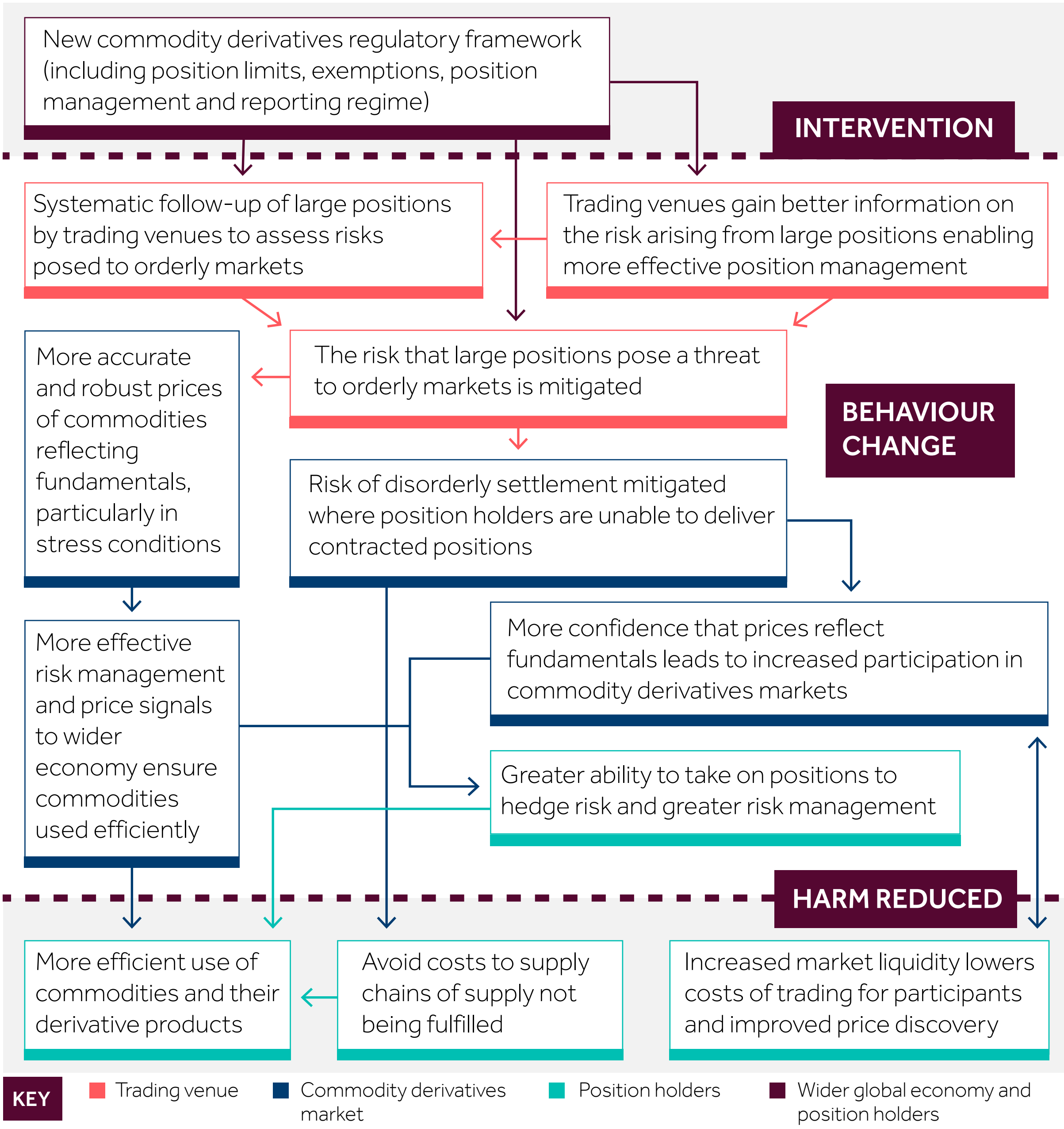
27. MiFID II provides an exemption, known as the ancillary activities exemption (AAE), from authorisation for firms that deal in commodity derivatives, emission allowances or derivatives of those instruments. Firms can use the exemption where, provided certain conditions are met, they carry out investment services or activities which are ancillary to their main business. In this consultation paper we propose to provide guidance on the (i) confirmation of our understanding of 'ancillary', that it is something 'related' and 'subordinate' to the main business of the group and (ii) confirmation that firms can look to the trading and capital employed thresholds used in the EU delegated regulation to judge what is ancillary. There is no statutory requirement in the FSMA 2000 for a cost benefit analysis (CBA) on guidance. It is our policy to produce a CBA for general guidance about rules where we identify 'an element of novelty which may be in effect prescriptive or prohibitive such that significant costs may be incurred'. We believe that the guidance follows from the recent changes made by legislation and therefore we do not CBA this element of our proposals.

The causal chain

28. Below we set out the steps in a casual chain through which our policy proposals reduce the harms we have identified. The introduction of a new regime targets significant positions in a small number of critical commodity derivatives contracts, in order to mitigate the harm that large positions could have on (i) prices, (ii) supply disruption and (iii) orderly markets.

29. We expect the proposed regime to mitigate the risk that large positions pose a threat to orderly markets. The proposed regime will enable trading venues to identify and manage large positions that pose risks to orderly markets. Where risks are identified we would expect position management measures put in place to manage that risk and help minimise the impact on prices in affected markets and prices to therefore reflect market fundamentals, such as underlying supply and demand. This would ensure that the price of commodity derivatives signals to the wider global economy the true scarcity of product and therefore it will be used efficiently in global supply chains. In addition, we would expect fewer instances where large positions lead to supply disruptions that impose direct costs on supply chains. Finally, we would expect better pricing and stable supply to encourage new participants to enter the market who would benefit from these advantages when hedging risk. In addition, more participation will increase liquidity and reduce the associated costs of trading.

Figure 1: The causal chain



Options considered

30. In reaching our proposals, we have considered a variety of changes to the regime. The regime is designed to deliver the benefits of a commodity derivatives regulatory regime without imposing undue costs on trading venues and market participants. In developing and designing the proposed regime, we have considered a range of alternative options.

Do nothing

31. Keeping the position limit framework unchanged from the current supervisory statement was discarded. This would continue the situation with information asymmetries, gaps and a lack of timeliness limiting the effectiveness of the regime and the ability of trading venues to manage risks arising from large positions. Further doing nothing would not consider the reforms under the Wholesale Markets Review and the resulting powers provided to us by FSMA 2023.

Setting of position limits

32. An alternative option would be to use thresholds to set the position limits for critical contracts. This approach of determining suitable thresholds for different types of contracts is discussed in the analysis of Chapter 4. Further, it would not be possible to adapt such thresholds to changing market conditions. The proposed approach whereby trading venues set limits within the framework proposed ensures that the limits are calibrated to the specific contract, the specific characteristics of that market and the underlying supply of the commodity.

Exemptions from position limits

33. The current position limits framework imposes constraints on market activity including on liquidity provision. This may harm the real economy by hindering liquidity access for non-financial firms to close positions, particularly during periods of market stress. To mitigate the costs to the real economy that the framework may impose, exemptions are provided to non-financial firms to enable them to continue to access liquidity and to manage their risk exposure.

34. We currently grant position limit exemptions to non-financial firms. Compared to trading venues, we are not as close to the business of individual participants or their trading activities. The asymmetric information when we are granting exemptions could result in insufficient scrutiny and does not consider the risk management condition mentioned in paragraph 23, or that there are no specific requirements to review the appropriateness of exemptions that have been granted.

35. Currently, there are no other exemptions but forbearance from position limits was granted for liquidity providers. In absence of a formalised liquidity provider or pass-through exemption, non-financial firms with an exemption may not have access to an equal and opposite position. In this case the non-financial firm is unable to access liquidity and hedge their risk.

36. Harm may also occur as a result of firms not having sufficient systems and controls to manage their risk while using the hedging exemption which may result in default or an inability to manage a position. This harm is mitigated by the proposed requirement for trading venues to only grant the hedging exemption where they satisfy themselves that the exempt positions can reasonably be managed, including the non-financial firm is able to unwind those positions in an orderly way during times of market stress where market liquidity may be constrained.

Baseline and key assumptions

Baseline

37. The costs and benefits of our proposals must be assessed against a baseline. We have taken into consideration our supervisory statement referred to in paragraph 31, offering forbearance on certain contracts where positions had gone above their position limits. Our supervisory statement in practice limited the scope of the position limits regime to agricultural contracts and physically settled contracts. The impact was a reduction of the scope of contracts subject to limits from over 800, to around 20 contracts. We assume in our baseline that, absent our proposals, here the supervisory statement would continue to apply. Therefore, in the baseline, the existing regime only applies to these physically settled and agricultural contracts, rather than over 800. As mentioned above, under the new regime the critical list covers 14 contracts, which includes 1 cash settled contract (T-West Texas Intermediate Light Sweet Crude Futures).

38. Trading venues currently apply other limits to positions in some contracts. Trading venues use these as tools for managing positions (eg delivery limits, expiry limits or accountability limits/thresholds) and they would still apply without this intervention. However, position management controls are not applied consistently across the contracts identified as critical (ie applied only by some trading venues or at the discretion of the trading venue for some contracts only), and do not take into consideration activity in related contracts. Trading venues also have already other systems and controls in place for monitoring positions. Additionally, following recent market events such as the events in the Nickel market in March 2022, LME committed to strengthening some elements of their position management by introducing accountability levels and weekly reporting of OTC positions on physically settled contracts (see LME decision for details). However, the systems currently in place across the trading venues may not cover all the contracts deemed critical and identified as related under the new regime.

39. In relation to position reporting without this intervention, firms and market operators would still need to report commodity derivatives positions traded on trading venues to the trading venue itself and us, respectively, as mandated by the UK regulatory framework. Trading venues also report publicly and to us weekly aggregated position information. Both trading venues and firms already have reporting systems in place to comply with these reporting requirements.

Number of firms affected

40. Our proposals introduce changes specifying the type of contracts that should be subject to position limits (ie critical and related contracts). The list of contracts subject to limits, and the number of trading venues and investment firms affected, could expand or narrow in the future, based on the establishment of new trading venues and the continuous assessment of contracts meeting those conditions.

41. However, for the purpose of this CBA, we identify **2 trading venues** directly affected: LME and IFEU. These trading venues are the ones currently offering trading in the critical contracts and will be expected to take responsibility for setting position limits and strengthening their position management controls. They will also start requiring further disclosures from trading firms on related positions, including OTC as required and start processing position limit exemptions.

42. Trading firms will also be required to be ready to share further information with trading venues where necessary (eg when they reach accountability thresholds). We estimate that around 8,200 position holders will be affected. This is based on the number of firms that had a position in at least 1 of the 14 contracts in 2022 in our Commodities Position Reporting (CPR) data.

Data

43. We have used our standardised cost model, supplemented with qualitative and quantitative information collected from surveys sent to the trading venues, to estimate the impact of our proposals. The information collected was used to calibrate the model. We have also used other data available via regulatory reporting on position holders (source: CPR), to estimate the number of trading firms impacted and the size their positions to inform our assessment of how they would be affected by our proposals.

Key assumptions

44. For the purposes of this CBA, we have made the following assumptions:

- costs estimated are in nominal terms
- we assume full compliance with our proposals once they are implemented
- in this CBA we use compliance officer salaries to estimate the market surveillance staff-related costs for trading venues

Summary of costs and benefits

45. The following table summarises the estimated costs and benefits of our proposals across all the proposals related to the positions limit regime. Most direct costs will be attributed to the 2 trading venues who will need to instate our proposals. However, given the trading venues already have some systems and controls in place, we do not expect the initial increase in costs to be greater than the benefits. We anticipate there will be a wider benefit of strengthening market integrity by introducing additional position management/reporting controls to manage associated risks.

Table 4: Summary of costs and benefits

Benefits		
• Orderly pricing of commodities ensures effective risk management for firms and the efficient use of commodities and their derivative products • Disorderly settlement disruptions that impose costs on supply chains are avoided • More accurate and robust pricing, particularly in stress conditions, increases confidence that prices reflect fundamentals and therefore there is greater use of commodity derivatives, increasing liquidity (hence reducing trading costs) and improving price discovery		
Participant type	**One-off costs**	**Ongoing costs**
Trading venues	Familiarisation and gap analysis costs: £20,000 Consultation and market engagement costs: £50,000-£100,000 Position limits and Accountability thresholds framework: £890,000 Position monitoring and management of information: £2m Managing exemptions: £30,000-£60,000. **TOTAL: £3.0m-£3.1m**	Scope of position limits: negligible Position limits and Accountability thresholds framework: £300,000 Position monitoring and management of information: £600,000-£770,000 Managing exemptions: £130,000 **TOTAL: £1m-£1.2m**
Position holders	Total familiarisation costs: £460,000 Consultation costs: £570,000 IT costs: £0.46-3.0m **TOTAL: £1.5m-£4.0m**	Costs of engaging with the trading venues: £80,000-490,000 **Total: £0.1-0.5m**
FCA	Scope of position limits: negligible	No costs expected

46. We note that the 10-year net present value (discounting at 3.5%) of the direct costs to trading venues are £11.9m - £13.5m (equivalent annual net cost of £1.4m - £1.6m). The 10-year net present value of the direct costs to position holders are £3.3m - £16m (equivalent annual net cost of £389,000-£1.9m). Overall, the 10-year net present value (discounting at 3.5%) of the direct costs are £15.3-29.5m (equivalent annual net cost of £1.8m-£3.4m).

Benefits

47. In this section, we set out our analysis of these benefits. We believe that it is not reasonably practicable to quantify the benefits of these proposals. Firstly, because the details of the new regime are to be decided by trading venues through a consultation. For instance, they will be making decisions on the levels at which each position limit will be set. Secondly, we do not think we can reasonably model the impact of position limits on market outcomes, especially given that the benefits will most likely occur during times of market stress or significant shocks to supply or demand.

Benefits from prices reflecting fundamentals

48. By assessing the risks associated with large positions taken in commodity derivatives contracts, limits will reduce the risk of disorderly trading or abusive practices. By preventing a position holder from influencing the price of a commodity by building a large position in the derivative contract, orderly pricing and delivery of the underlying commodity can be maintained.

49. If prices more accurately reflect fundamentals, correct signals are sent to the real economy on the production and use of commodities. This more accurate pricing results in a reduction of inefficiency costs to society by market inefficiencies. The false high prices (or low prices) prevent trades that would be welfare enhancing were they to take place. For example, in the face of false high prices, demand for commodities will be too low given market fundamentals and underlying supply. This will mean that commodities are underutilised, those seeking to buy commodities would ration their use and some welfare enhancing trades are prevented. In other situations, market prices may be too low, given fundamentals, and commodities may therefore be used inefficiently (ie where the true cost of the commodity is above the value placed on its use by those buying it).

Benefits from orderly delivery of commodities

50. The proposed regime will reduce the risk that large positions create situations where physically deliverable positions exceed the supply of an available commodity. By limiting the supply issues for those market participants that need it, supply chains can avoid the costs that arise where expected supply is unavailable or delayed because of disorderly trading conditions.

Benefits from greater participation in commodity derivative markets

51. In addition, by preventing dislocation in prices or supply issues, participants will have more confidence in using the UK's commodity derivatives markets and therefore potentially increase the number and size of the positions they take. These participants will gain from their ability to hedge the costs of their business, and therefore will be more able to bear risks. This could lead them to be more efficient in their production. Overall, we expect a positive effect on liquidity and price discovery. Trading venues will benefit from this increased participation from increased fees from higher volumes of trading and may mitigate the loss of revenue and associated costs related to a market suspension.

52. We note that, in theory, the introduction of position limits can reduce market participation by limiting positions for those wishing to enter into large positions. By preventing these large positions, transactions that would have occurred in a free-market liquidity and price discovery for contracts could be affected. However, in developing our proposals we had regard to supporting liquidity, for example when determining the list of critical contracts, for which harms from abusive practices can negatively impact liquidity to a greater degree and affect a greater number of market participants than if there were no such measures.

Benefits from reduced risk to CCP

53. In addition, participants may want to enter large positions as they have identified new information about the future supply of a particular commodity. The regime lowers the potential returns from monetising such information and help prices reflect the current and not expected future supply available.

Costs

54. This section provides an analysis and estimation of the costs of our proposals. It considers the compliance costs of trading venues, the costs to position holders and the indirect costs to the market from our proposed requirements.

Calculating costs

55. We collected costs information from the 2 trading venues (IFEU and LME). We do not report these costs directly in our CBA but have used these to inform our cost estimates. This is to avoid publishing firm specific costs. Costs have therefore been estimated using the standardised cost model. Customised calibrations have been obtained from engagement with trading venues. These are reported below under each section.

Costs to trading venues

56. We expect costs for trading venues from setting and regularly reviewing position limits, and from monitoring and managing clients' positions using other systems and controls and newly received OTC information.

57. The table below sets out our costs estimates for trading venues.

Figure 2: Trading venue compliance costs

Cost	One-off	Ongoing
Familiarisation costs	£20,000	
Consultation costs	£50,000-£100,000	
Position limits and accountability thresholds framework	£890,000	£300,000
Position monitoring and the management of information	£2,040,000	£600,000-£770,000
Granting and monitoring exemptions	£30,000-£60,000	£130,000
Total	£3.0m-£3.1m	£1.0m-£1.2m

Familiarisation costs and gap exercise

58. We expect one-off costs associated to compliance staff having to read this consultation paper (about 60 pages) There are 300 words per page, and we assume the reading speed is 100 words per minute. This means the consultation would take around 3 hours to read. We also assume that it would be reviewed by 20 compliance staff that have an hourly cost of £63.

59. We also expect that there will be legal analysis costs from legal staff reading final legal instrument (about 50 pages). We assume that it takes around 30 hours to read the instrument and that 4 team members review the legal instrument at a cost of £74 per hour.

60. We estimate these costs as £10,000 per venue and £20,000 overall.

Consultation costs

61. We expect trading venues would incur one-off consultation costs with their members. Trading venues have indicated that these interventions would require market engagement or a formal consultation and subsequent education on any changes with respect to the current process. We have estimated that the cost of running a consultation could range between £25,000 - £50,000 for each trading venue. Overall, we expect these costs to be £50,000-100,000 for both trading venues. This is based on the work of 3 full-time employees (FTEs) for 1-2 months respectively. The efforts related to the consultation process will depend on the extent to which trading venues currently have arrangements in place that provide for member consultation with respect to existing limits or thresholds set by the trading venue.

62. After the initial member consultation, we do not expect any member consultations for position limits to be as extensive given position limits that concern changes or new contracts will not cover the full set of critical contracts, and therefore we do not expect ongoing consultation costs for trading venues. We consider the costs to members from these consultations below.

Costs related to the position limits and accountability thresholds framework

63. Trading venues will assume a new responsibility and take control over the level of the position limits and accountability thresholds to be set for at least those critical contracts required to have position limits. Both trading venues will have to develop a methodology and a system to monitor and enforce position limits. As trading venues currently have some limits in place, the one-off costs for setting a methodology for calculating the level of the limits are likely to be minor. However, trading venues will have to dedicate resources in identifying the contracts that are related to the critical ones.

64. One-off governance costs and project set-up costs: we have assumed that any project set-up changes will require a total of 1080 person days, attributed to the work of the project team and the Board's and Executive Committee's oversight. We estimate that each trading venue would have an initial one-off cost of £445,000.

65. Trading venues will be expected to ensure that their position limits are appropriate at all times. There will be ongoing costs attributed to reviewing the methodology used and assessing whether the position limits and accountability thresholds are set at the right level. Trading venues are expected to review the limits and the thresholds when there is a significant change in deliverable supply, open interest or to any of the criteria. At a minimum, they should be reviewed annually. The periodic review of the methodology could be left to our supervisory approach and should be less frequent than for position limits. Finally, trading venues will have to make limits information available and accessible to clients and members on their website. The latter cost is considered insignificant due to the negligible resources needed to create and maintain an additional webpage.

66. Ongoing cost for Market Surveillance Resourcing: We estimate that trading venues will hire at least 1 additional compliance officer on a permanent basis. This will be necessary as position limits will have to be reviewed at least annually. A revision of the methodology for their calculation could be necessary at least every 3 years. We estimate this cost to be £60,000 per year for each venue, according to our standardised cost model estimate for compliance staff salaries.

67. Ongoing costs for project changes: Trading venues will incur costs from reviewing limits, methodologies, and approving changes before they are introduced. In addition to the additional staff hired, we assume 20% of the initial year 1 project set-up costs for setting the limits (£450,000) will recur. This would imply an annual cost of £90,000 per trading venue.

68. Overall, we expect one-off costs of £890,000 and ongoing costs of £300,000.

Costs related to position monitoring and the management of information

69. Trading venues are expected to employ position limits and accountability thresholds as key tools for managing risks and monitoring the building up of positions in the critical markets. Since industry practice is that some limits on positions are already in place, we expect that trading venues already have systems to respond to limit breaches.

70. However, we expect that trading venues will have to adapt their systems to some extent in order to incorporate positions in the related contracts. IT costs are expected so that trading venues can consider, among others, activity in the related contracts when aggregating positions, enforcing the position limits, and reacting to breaches in the accountability thresholds. Based on consultation with trading venues, we expect a significant one-off investment in tailoring IT systems to identify large positions and, where applicable, receive additional information. The systems improvement should also target the storing and analysis of newly received information from position holders, including resulting from hedging exemption applications. This information should be part of the trading venues' toolkit to enhance their existing position management controls.

71. IT investment: We have assumed that the project change would require the contribution of 2000 person days, proportionally distributed among teams. It is estimated that each trading venue would have a one-off cost of £870,000. In addition, we expect ongoing costs in maintaining software infrastructure and support. Based on our engagement with the trading venues, we expect that there will be a 20%-30% of the initial expense on recurrent costs per trading venue. The resulting ongoing IT costs would be £170,000-£260,000.

72. There will also be significant costs for the trading venues from i) setting up a process for determining when and how often additional information is needed and ii) integrating any new information received from members and/or clients. Trading venues may therefore also incur further costs from governance, project changes and expanding their market surveillance force.

73. One-off Governance costs: there will be one-off major costs on setting new processes and changing projects. We have assumed that each trading venue will dedicate 260 person days attributed to the work of the project team and the Board and Executive Committee oversight. We estimate that each trading venue would have an initial cost of £110,000.

74. One-off Training costs: new and existing staff will have to be trained on risk management and assessment. We have assumed that each trading venue will offer a week of bespoke training to existing employees and their new hires. For a team of 15 employees in the market surveillance team, we estimate a one-off cost of £40,000 per trading venue.

75. Ongoing market surveillance resourcing: We expect that trading venues will hire additional staff to support their position management function. We have assumed that trading venues will incur in ongoing salary costs for at least 2 additional FTEs, up to £130,000 per trading venue.

76. In total, we expect one-off costs of £2m and £600,000-770,000 ongoing, for both trading venues.

Costs of granting and monitoring exemptions

77. Under MiFID II, hedging exemptions already exist. However, the responsibility for monitoring and granting this exemption will be transferred to trading venues. In addition, trading venues will also have to devise and run processes and procedures relating to 2 new types of position limit exemptions (pass-through and the liquidity provider exemptions) and monitor these exemptions.

78. The costs we expect for trading venues arise from 1) the review of applications 2) where applicable, the implementation and monitoring of exemption ceilings and 3) where applicable, request and analysis of information to be provided to evidence use of the exemption and of additional information where an exemption ceiling is exceeded. We would expect that trading venues are able to tailor their IT investments (mentioned in previous sections) to set controls for monitoring the use of exemptions and distance from the ceiling limits, where applicable. In addition, we would expect trading venues to expand their teams to be able to process applications. A process should also be established by which the trading venue can decide whether further information is needed.

79. One-off Governance costs: we assume that any one-off project set-up changes will be small, although variation is expected across trading venues based on current capabilities. Using the standardised cost model, we estimate that trading venues will spend 30-60 person days in the process of establishing a system for receiving, processing and granting exemptions. The effort is attributed to the work of the project team and the Board and Executive Committee oversight. We estimate that each trading venue would have an initial cost of £15,000-£30,000.

80. Ongoing market surveillance resourcing: monitoring and processing of exemptions will require the time of a person on an ongoing basis. Based on our engagement with the trading venues, we estimate that trading venues will hire at least 1 additional FTE to join their market surveillance function. We estimate that each trading venue would incur a cost of £65,000 per year. However, these costs could be higher based on the number of applications received by the trading venue.

81. We therefore expect the trading venues' overall cost for granting and monitoring exemptions to be £30,000-60,000 one-off and, £130,000 ongoing.

Costs to position holders

Familiarisation costs

82. There will be one-off familiarisation costs for all participants trading on the critical contracts, as they seek to understand the changes to the commodity derivatives regulatory regime.

83. We expect that participants are, at least, expected to read the consultation and get familiar with the proposals. There were 8,200 position holders that held positions in the critical contracts in 2022. The majority of position holders never hold positions that are a significant part of the overall market and therefore will be little affected by our proposals. To identify position holders that are more likely affected by our proposals we identify position holders that had a position greater than 5% of the current position limits on the critical contracts in 2022. There were around 400 such position holders.

84. We estimate familiarisation costs for these position holders assuming that they need to read 60 pages of this consultation paper. We still assume 300 words per page and reading speed of 100 words per minute and so would take 2.8 hours to read. We assume that 6 members of staff review the consultation at a cost of £74 per hour. This implies a cost of £1,000 per firm and £460,000 overall.

Consultation costs

85. The main trading venues will run a consultation too, to which members are expected to respond to and engage with. We would expect this process to impose a similar cost on firms to understand the trading venues' proposals (and provide consultation responses). Around 100 position holders of the 400 in 2022 had positions on both venues and therefore will incur these costs twice. Consequently, the cost of the additional familiarisation and consultation for the 500 responses is £570,000.

Reporting costs

86. Firms holding positions in any of the critical contracts may be subject to further reporting obligations if they build positions over the accountability thresholds that trading venues will set. Another condition for additional reporting is exceeding the size of the ceiling, where an exemption ceiling applies. For some markets a risk-sensitive approach may require the provision of a broader and more regular set of data, which will depend on the features of the market.

87. The number of firms potentially subject to additional reporting is hard to predict. However, based on historical data on positions held in any of the critical contracts, we do not expect many position holders to be affected. This is because the majority of position holders never hold positions that are a significant part of the overall market.

88. To estimate the costs of reporting, we first identified the position holders that held a position of at least 20% of the position limit in 2022 in each contract. Aggregating across all contracts included in our proposed position limits regime, there were 155 instances where a firm was above 20% of the position limit in one of the 14 specified contracts in 2022. Some firms were identified twice as they held large positions in more than one contract. We also used a threshold of 50%. This threshold identified 24 such instances where a firm was above 50% of the position limit in 2022. For the purposes of calculating potential costs for market participants, we use a population of position holders between 24 and 155 firms.

89. Reporting costs will arise in 2 ways. Firstly, affected position holders will need to ensure that there are processes/systems in place to collate and report their positions. We assume that each position holder institutes an IT project which requires 46 person days at an average cost of £19,000 per position holder. Using the range of position holders estimated above we expect overall IT costs of £460,000- 3.0m.

90. In addition, position holders will incur costs from responding to requests from trading venues for more information or other investigations of positions. There will also be additional costs to position holders of applying for exemptions. We assume that these are ongoing resource costs from each position holder of 5% of an FTE at compliance staff salaries.

91. In relation to exemptions applicants, there are over 80 firms currently that have benefitted from the hedging exemption since 2017 and that had to provide evidence to us. The additional reporting costs for these firms are expected to be much lower than estimated, as they already have their capability built in. We note some of these costs may be front loaded for these position holders and that these one-off and ongoing costs might be negligible or lower.

92. Overall, we expect these costs to be £1.5– 4.m ongoing for all position holders.

93. In contrast, trading venues will be expected to consider any position on critical and related contracts which are yet to be identified, when evaluating the size of positions against the accountability threshold. We could therefore be underestimating the potential number of position holders affected.

Indirect costs

94. As already is the case prior to the proposed reduction of contracts in scope, there could be impacts on the price formation process if participants are asked to reduce positions or cannot increase their positions to the level they desire because of our proposed framework.

95. The exemptions available from position limits will enable non-financial firms to hedge, financial firms to manage their risk (when dealing with commercial clients) and liquidity providers to provide liquidity without being caught by position limits. This will limit the costs to position holders of the position limits regime and only prevent large positions where there are risks of disorderly markets.

96. Even so, binding position limits will have effects on the position holders directly affected and on the wider functioning of the market. We do not think it reasonably practicable estimating these costs. In the benefits section above we explained why we could not estimate the benefits. Those reasons apply equally here.

Impact on position holders

97. Position limits will ultimately restrict specific position holders. This prevents them from taking on positions that they may otherwise like to take. As their positions are limited, they will not be able to benefit from the proportion of their desired position over the limit.

98. Position holders may seek to replicate positions that are constrained by position limits by switching to alternative markets. Other markets may not offer the liquidity or contracts that are good substitutes for the UK traded contract. The costs of these trades may also be higher on those alternative markets.

99. In addition, UK trading venues would have limited visibility of the risks to their markets where certain participants move entire exposures to alternative markets, including OTC. However, position holders would lose the benefit of trading in the deep, liquid markets offered by trading venues.

Competitiveness and growth

100. On 29 June 2023 the Financial Services and Markets Bill became law (it is now the FSMA 2023) and gave the FCA a secondary objective to facilitate the international competitiveness of the UK economy (particularly the financial services sector), and its medium to long-term growth, subject to aligning with relevant international standards. We have therefore considered here the likely effects of these proposals on international competitiveness and growth.

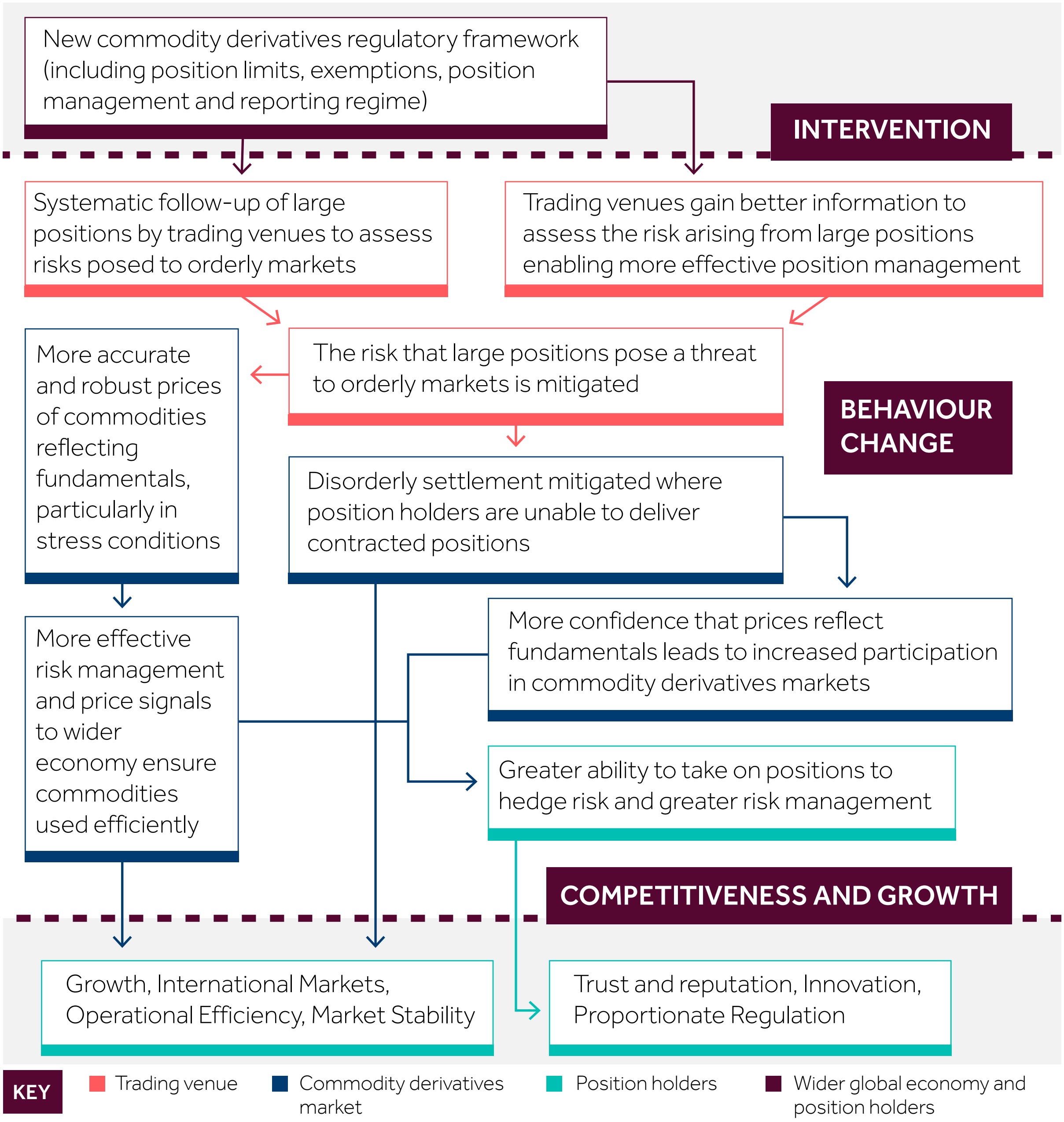
101. The proposed reform is an opportunity to ensure the UK's commodity derivatives markets remain resilient in light of recent market events and excessive volatility. While we propose to remove and amend provisions that impose unnecessary and disproportionate burdens on firms that are not delivering material benefit to the functioning and safeguarding of the market, our proposals remain cognisant of the underlying risks and weaknesses identified by stressed market conditions.

102. The policy proposals presented in this paper align with the core mandate of the new secondary objective, promoting growth in the UK in the medium to long term and international competitiveness of the UK economy. The proposals facilitate the secondary international competitiveness and growth objective in the following way:

- Growth. Addressing the harms through our policies will support growth both in commodity derivative markets and the broader real economy. By addressing harms caused by the abuse of a large position and by reducing the risk of disorderly trading in commodity derivatives markets, orderly pricing conditions support market confidence, increased participation, and therefore market growth. The policies also address harms extending to physical markets resulting in less disruption of commodities delivery and cost savings to manufacturers and consumers. New exemptions will support risk management which may benefit the real economy. As a result, the proposals support growth in the broader economy through a more efficient and orderly commodities derivatives market.
- Operational efficiency. The proposals for the position limits framework (including exemptions granting) will produce a more operationally effective and efficient framework by utilising trading venues' informational advantage and proximity to the market to allow timely decision making. This will eventually increase the operational efficiency of FCA oversight.
- Proportionate regulation. The policy proposals ensure the scope of the regime is appropriately balanced against the risks. This will strengthen the competitiveness of UK markets by focusing market oversight on critical and related contracts that carry the greatest risk of harm where policy benefits exceed the costs. Non-financial participants along with financial participants engaging in the market to facilitate commercial hedging activity and also liquidity providers will be exempt to ensure the regime is proportionate to the risks.
- Trust and reputation. The changes to the position limits framework are designed to mitigate harms from market abuse and/or disorderly trading in the commodity derivatives market more effectively, and so support competitiveness by enhancing trust and confidence for market participants. Greater confidence in the market supports further market participation - increasing market size and liquidity to produce a more efficient commodity derivatives market.
- Innovation. The new position limits framework supports innovation by limiting its scope to critical and related contracts where the risk of harm is high. Nascent contracts will be out of scope to support innovation and competitiveness unless there is a risk of circumventing the protections provided by the proposed regime by not including the contract in scope or where a contract is likely to be liquid from inception.
- Market stability. Disorderly trading can have costs for market participants, such as reduced liquidity and higher trading costs that reduce the competitiveness and efficiency of relevant markets. The policy proposals support competitiveness by mitigating the risk of disorderly trading and market abuse through more effective regulatory oversight and greater provision of information that helps better inform market pricing. Additional exemptions for financial firms offering risk-mitigation services to clients and liquidity providers further supports risk management in financial markets and the broader economy.

103. International markets. The attractiveness of UK commodities derivatives trading markets will be enhanced by delivering a regime that better mitigates the risk of harms that hinder trading activity (poorly informed market pricing, liquidity challenges, more costly and disorderly trading) while ensuring a scope that is proportionate against the risks with appropriate exemptions for hedging activities. This will encourage further participation in UK commodity derivative markets by offering traders a more efficient and orderly market. In developing our approach, we have also looked at the regimes in other jurisdictions and taken account of the recently updated IOSCO Principles for the Regulation and Supervision of Commodity Derivatives Markets. And while market participants could move their entire exposures to alternative markets (including OTC markets) as above, there would be missed opportunities to benefit from the deep, liquid markets offered by trading venues. We consider our proposed regime to be comparable to the regimes in the United States and European Union.

Figure 3: How our proposals affect UK competitiveness and growth



Monitoring and evaluation

104. As we noted in paragraphs 1.27 and 1.28, we intend to monitor the operation of the commodity derivatives regulatory regime. As indicated in our Strategy 2022 to 2025, we will use a variety of metrics to assess whether our work is strengthening the UK's position in global wholesale markets. To assess this, we will look at the frequency of breaches of position limits and accountability thresholds and the actions taken to address those breaches. We will also consider the extent to which reporting requirements allow trading venues to operate their market surveillance arrangements as intended or whether further information is necessary. We will also consider whether implementation of the regulatory regime has impacted liquidity in relevant markets and, to the extent possible, the operation of relevant markets in times of market stress. Finally, we will consider whether the overall reform has reduced unnecessary costs and administrative burdens for firms.

Q1: Do you have any comments on our cost benefit analysis?

Annex 3

Compatibility statement

Compliance with legal requirements

1. This Annex records our compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of our reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

2. We are consulting on new rules and a standards instrument revoking and amending various technical standards, as such the FCA is required by section 138I(2)(d) FSMA and section 138S FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty, under s. 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, (b) so far as reasonably possible, advances the secondary international competitiveness and growth objective, under section 1B(4A) FSMA, and (c) complies with its general duty under s. 1B(5)(a) FSMA to have regard to the regulatory principles in s. 3B FSMA. The FCA is also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons. References to rules in this section also include requirements in technical standards.

3. This Annex also sets out our view of how the proposed rules are compatible with the duty on the FCA to discharge our general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing our consumer protection and/or integrity objectives.

4. In addition, this Annex explains how we have considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of His Majesty's Government to which we should have regard in connection with our general duties.

5. This Annex includes our assessment of the equality and diversity implications of these proposals.

6. Under the Legislative and Regulatory Reform Act 2006 (LRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRA.

The FCA's objectives and regulatory principles: Compatibility statement

7. The proposals set out in this consultation are primarily intended to advance our operational objective of market integrity. They are also relevant to our consumer protection and competition objectives.

8. As outlined in Chapter 2 of this consultation paper, our proposed changes are primarily aimed at ensuring that the UK's commodity derivatives markets remain resilient and orderly by, for example, strengthening reporting requirements that enable trading venues to identify risks from other relevant markets. Where risks are not identifiable, they can be transmitted to other parts of the financial system. We expect our proposed changes will protect and enhance the integrity of the UK financial system.

9. Further, our proposals are relevant to the consumer protection objective. Whilst developing our proposals we had regard to ensuring that relevant markets continue to serve end users like commercial firms. Users of these markets and by extension consumers, who are the end users of basic commodities, have an interest in UK commodity derivatives markets that are fair, transparent and operate with integrity.

10. Similarly, our proposals are relevant to the competition objective. In developing our proposals, we had regard to ensuring that relevant markets continue to remain open and liquid. UK is home to global reference markets for certain commodities. Our rules affect market participants globally and how they compete. We propose to introduce exemptions from position limits that would otherwise inhibit the provision of liquidity, which in times of market stress can become significantly important. Market liquidity supports competition and efficiency.

11. We consider these proposals are consistent with our strategic objective of ensuring that the relevant markets function well. They are aimed at improving the functioning of commodity derivatives markets through measures that are aimed at mitigating the risk of market abuse and to orderly pricing and settlement conditions. These risks can cause much harm, particularly during times of market stress. For the purposes of our strategic objective, 'relevant markets' are defined by s. 1F FSMA.

12. We consider these proposals support our secondary objective in advancing competitiveness and growth, as outlined in Chapter 2 above, by strengthening the regulatory framework to make it more resilient, removing obligations that don't promote market integrity in an effective way and by introducing obligations that help increase our operational efficiency because.

13. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA.

The need to use our resources in the most efficient and economic way

14. The proposals set out in this consultation are consistent with an efficient and economic use of our resource. Our proposals concern the transfer of responsibilities from us to trading venues with respect to setting position limits and administering exemptions. Our proposals recognise that trading venues have the market proximity to set position limits effectively and to quickly change them if market conditions require. In this regard, these changes will reduce the amount of supervisory resource needed.

The principle that a burden or restriction should be proportionate to the benefits

15. As set out in the cost benefit analysis we have estimated the costs and benefits of our proposals. We are satisfied that the net benefits of these proposals outweigh and justify the costs.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

16. We have had regard to this principle including the government's aim of seeing more competition and innovation in all sectors of the UK's financial industry.

The general principle that consumers should take responsibility for their decisions

17. The proposals do not depart from the general principle that consumers take responsibility for their decisions.

The responsibilities of senior management

18. The proposals leverage existing requirements to make clear the responsibility of a trading venue's senior management in carrying out regulatory obligations under the new regime.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

19. We have spoken to a wide range of market participants in preparing these proposals. This has been done to seek to ensure that our proposals recognise differences, and objectives of, businesses carried on by different persons and their interest in how the new regime will operate.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

20. Currently requirements are placed on trading venues to publish weekly aggregated position reports. We are maintaining these requirements with the possibility of minor technical changes which are dependent on the outcome of the consultation.

The principle that we should exercise our functions as transparently as possible

21. Our consultation processes are intended to ensure that we are transparent about the thinking behind our proposals and clearly explain what we expect to achieve. We believe that this consultation meets these objectives. We have also spoken to a wide range of market participants in developing these proposals for rules changes.

22. In formulating these proposals, we have had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s. 1B(5)(b) FSMA).

Expected effect on mutual societies

23. We do not expect the proposals in this paper to have a significantly different impact on mutual societies.

Compatibility with the duty to promote effective competition in the interests of consumers

24. In preparing the proposals as set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers.

Equality and diversity

25. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.

26. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in Chapter 2 of this consultation.

Legislative and Regulatory Reform Act 2006 (LRRA)

27. We have had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance and consider that they are proportionate and consistent with the need for increased transparency.

28. We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance and consider that the proposals are proportionate to the potential market failures identified.

Annex 4

Abbreviations used in this paper

Abbreviation	Description
AAE	Ancillary activities exemption
AAT	Ancillary activity test
Balmo	Balance of the month
CCP	Central Counterparty
CFTC	Commodity Futures Trading Commission
CoT	Commitment of Traders
EE	Economically equivalent
EFP	Exchange for physical
EEOTC	Economically equivalent over-the-counter
EU	European Union
FBOT	Foreign boards of trade
FSMA	Financial Services and Markets Act
FTE	Full-time employee
IFEU	ICE Futures Europe
IOSCO Principles	IOSCO Principles for the Regulation and Supervision of Commodity Derivatives Markets
LME	London Metal Exchange

Abbreviation	Description
MAR	Market Conduct Sourcebook
MiFI	Markets in Financial Instruments Regulations 2017
MiFID II	The second Markets in Financial Instruments Directive
MiFID RTS 20	UK version of Commission Delegated Regulation 2017/592
MiFID RTS 21	UK version of Commission Delegated Regulation 2017/591
MTF	Multilateral Trading Facility
NCA	National Competent Authority
Order 2023	Financial Services and Markets Act 2000 (Commodity Derivatives and Emission Allowances) Order 2023
OTC	Over-the-counter
OTF	Organised Trading Facility
PRA	Price Reporting Agency
RIE	Recognised Investment Exchange
RRRs	Recognition Requirements Regulations
RTS	Regulatory Technical Standard
UK MiFID	UK Markets in Financial Instruments Directive
US	United States

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

We are obliged to list the names of respondents, which is a matter separate from any request for the content of a response to be kept confidential. However, we will only publish the name of a respondent to a consultation where that respondent has consented to the publication of their name.

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Appendix 1

Draft Handbook text and standards instrument text

COMMODITY DERIVATIVES (POSITION LIMITS, POSITION MANAGEMENT AND PERIMETER) INSTRUMENT 2024

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of:

(1) the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(a) section 137A (The FCA's general rules);
(b) section 137T (General supplementary powers);
(c) section 139A (Power of the FCA to give guidance);
(d) section 293 (Notification requirements);
(e) section 300H (Rules relating to investment exchanges and data reporting service providers);
(f) section 395 (The FCA's and PRA's procedures);

(2) regulation 11 of the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges, Clearing Houses and Central Securities Depositaries) Regulations 2001 (SI 2001/995);

(3) regulation 15A of the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017 (SI 2017/701); and

(4) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Amendments to the Handbook

C. The modules of the FCA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes in this instrument listed in column (2) below.

(1)	(2)
Glossary of definitions	Annex A
Market Conduct sourcebook (MAR)	Annex B
Decision Procedure and Penalties manual (DEPP)	Annex C
Recognised Investment Exchanges sourcebook (REC)	Annex D

Amendments to material outside the Handbook

D. The Enforcement Guide (EG) is amended in accordance with Annex E to this instrument.

E. The Perimeter Guidance manual (PERG) is amended in accordance with Annex F to this instrument.

Commencement

F. This instrument comes into force on [*date*].

Notes

G. In the Annexes to this instrument, the notes (indicated by "*Editor's note*:" or "**Note**:") are included for the convenience of readers but do not form part of the legislative text.

Citation

H. This instrument may be cited as the Commodity Derivatives (Position Limits, Position Management and Perimeter) Instrument 2024.

By order of the Board
[*date*]

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

accountability thresholds	the additional position management controls a *trading venue* applies, in accordance with *MAR* 10.3.3AR, in relation to the *critical contracts* and *related contracts* traded on its systems.
additional reporting	the additional reporting to a *trading venue operator* required by *MAR* 10.3.3DR.
critical contract	a contract, specified in *MAR* 10.2.1AR, which is in summary a contract in respect of a *commodity derivative*: (1) traded on a *trading venue* in the *UK*; (2) to which *MAR* 10 Annex 2 applies or which is otherwise critical to or significant for the purposes of the functioning of the *commodity derivatives* markets in the *UK*; and (3) for which a *trading venue* is required to impose a position limit in accordance with *FCA rules*.
exemption ceiling	a size limit however imposed on a position limit exemption on a risk-sensitive basis in accordance with *MAR* 10.2.25R.
hedging exemption	an exemption granted by a *trading venue* to a *non-financial entity* in respect of its position for the purposes of a position limit relating to a *commodity derivatives* contract.
open interest	the number of lots of a *commodity derivative* that are outstanding on *trading venues* at any point in time.
other months' contract	a *commodity derivative* contract which is not a *spot month contract*.
related contract	a *commodity derivative* contract traded on a *trading venue* in the *UK*: (1) the settlement price of which is linked to the settlement price of a *critical contract*, including any *option*, *contract for differences*, balance-of-month (balmo), mini and mini-balmo contract relating to the *critical contract*; or (2) which references a *critical contract*; or

	(3) which has as its underlying the same *commodity* as the underlying of a *critical contract* including for delivery at a location specified in the *critical contract*.
related OTC contract	(1) an *OTC derivative* contract, the settlement price of which is linked to the settlement price of a *critical contract*; or (2) an *OTC derivative* contract which: (a) references a *commodity derivatives* contract to which a position limit applies; or (b) has as its underlying the same *commodity* as the underlying of a *critical contract* including for delivery at a location specified in the *critical contract*; or (3) an over the counter contract subject to an over the counter contract policy administered by a *trading venue operator*.
related overseas commodity derivative contract	(1) a *commodity derivatives* contract traded on an overseas *trading venue*, the settlement price of which is linked to the settlement price of a *critical contract*; or (2) a *commodity derivatives* contract traded on an overseas *trading venue* which: (a) references a *commodity derivatives* contract to which a position limit required by *MAR* 10 applies; or (b) has as its underlying the same *commodity* as the underlying of a *critical contract* including for delivery at a location specified in the *critical contract*.
spot month contract	the *commodity derivative* contract in relation to a particular *commodity* whose maturity is the next to expire in accordance with the rules set by the *trading venue*.
trading venue operator	a *person* operating a *UK trading venue* or an *MTF* or *OTF* operated by a *third country investment firm* from an establishment in the *United Kingdom*.
weekly report	(for the purposes of *MAR* 10) a weekly report on aggregate positions held by different categories of *persons* for the different *commodity derivatives* or *emission allowances* traded on *trading venues* as described in *MAR* 10.4.3R.

Amend the following as shown.

financial entity	(in *MIFIDPRU*) any of the following: …

(5) …

…

(c) …

(in *MAR* 10) any of the following:

(1) a *MiFID investment firm* authorised as such by means of a *Part 4A permission* or an *investment firm* authorised in accordance with *MiFID*;

(2) a *CRD credit institution* or a *credit institution* authorised in accordance with *CRD*;

(3) an insurance undertaking authorised as such by means of a *Part 4A permission* or in accordance with Directive 73/239/EEC;

(4) an assurance undertaking authorised as such by means of a *Part 4A permission* or in accordance with Directive 2002/83/EC of the European Parliament and of the Council;

(5) a *reinsurance undertaking* authorised as such by means of a *Part 4A permission* or in accordance with Directive 2005/68/EC of the European Parliament and of the Council;

(6) a *UCITS* and, where relevant, its *management company*, authorised as such by means of a *Part 4A permission* or in accordance with the *UCITS Directive*;

(7) an *occupational pension scheme* or an institution for occupational retirement provision within the meaning of article 6(a) of Directive 2003/41/EC of the European Parliament and of the Council;

(8) an *alternative investment fund* managed by an *AIFM*:

  (a) authorised as such by means of a *Part 4A permission*;

  (b) authorised or registered in accordance with the *AIFMD*; or

  (c) registered as such pursuant to the *AIFMD UK regulation*;

(9) a *CCP* authorised in accordance with *EMIR* or recognised as such by means of a recognition order under Part XVIII of the *Act*; and

(10) a central securities depositary authorised in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council or recognised as such by means of a recognition order under Part XVIII of the *Act*.

A third-country entity is a *financial entity* if it would require authorisation under any of the aforementioned legislation if it was based in the *United Kingdom* and subject to *UK* law.

non-financial entity

~~(as defined in article 2(1) of *MiFID RTS 21*)~~ (in *MAR* 10) a natural or legal *person* other than~~:~~ a *financial entity*.

~~(a) a *MiFID investment firm* authorised as such by means of a *Part 4A permission* or an *investment firm* authorised in accordance with *MIFID*;~~

~~(b) a credit institution authorised in accordance with Directive 2013/36/EU of the European Parliament and of the Council or a *CRD credit institution*;~~

~~(c) an *insurance undertaking* authorised as such by means of a *Part 4A permission* or in accordance with Directive 73/239/EEC;~~

~~(d) an assurance undertaking authorised as such by means of a *Part 4A permission* or in accordance with Directive 2002/83/EC of the European Parliament and of the Council;~~

~~(e) a *reinsurance undertaking* authorised as such by means of a *Part 4A permission* or in accordance with Directive 2005/68/EC of the European Parliament and of the Council;~~

~~(f) a *UCITS* and, where relevant, its *management company*, authorised as such by means of a *Part 4A permission* or in accordance with the *UCITS Directive*;~~

~~(g) an institution for occupational retirement provision within the meaning of article 6(a) of Directive 2003/41/EC of the European Parliament and of the Council or an *occupational pension scheme*;~~

~~(h) an *alternative investment fund* managed by *AIFMs* authorised or registered in accordance with the *AIFMD* or authorised as such by means of a *Part 4A permission* or registered as such pursuant to the Alternative Fund Managers Regulations 2013;~~

~~(i) a *CCP* authorised in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council or recognised as such by means of a recognition order under Part XVIII of the *Act*;~~

~~(j) a central securities depositary authorised in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council or recognised as such by means of a recognition order under Part XVIII of the *Act*.~~

~~A third-country entity is a non-financial entity if it would not require authorisation under any of the aforementioned legislation if it was based in the *United Kingdom* and subject to *UK* law. [Note: article 2 of *MiFID RTS 21*]~~

[*Editor's note*: the definition of 'UK trading venue' takes into account the proposals and legislative changes suggested in the consultation paper 'The Framework for a UK Consolidated Tape' (CP23/15) as if they were made final.]

UK trading venue	for the purposes of *MAR* 9 <u>and *MAR* 10</u> (and in accordance with article 2(1)(16A) *MiFIR*), a *UK RIE*, a *UK MTF* or a *UK OTF*.		
working day	(1)	(in *PRR*<u>,</u> ~~and~~ *COMP* <u>and *MAR* 10</u>) (as defined in section 103 of the *Act*) any day other than a Saturday, a Sunday, Christmas Day, Good Friday or a day which is a bank holiday under the Banking and Financial Dealings Act 1971 in any part of the *United Kingdom*.	
	…		

Annex B

Amendments to the Market Conduct sourcebook (MAR)

In this Annex, underlining indicates new text and striking through indicates deleted text.

10 Commodity derivative position limits and controls, and position reporting

10.1 Application

Introduction

10.1.1 G (1) The purpose of this chapter is to ~~implement articles 57 and 58 of *MiFID* by setting~~ set out the ~~necessary directions,~~ *rules*, directions and *guidance* relating to position limits, position management controls and position reporting in *commodity derivatives*. The regulatory framework aims to ensure that *commodity derivatives'* markets function well, including by mitigating the risk of *market abuse*, and supporting orderly pricing and settlement conditions. The framework has regard to supporting the liquidity of *commodity derivatives'* markets and enabling these markets to serve commercial users' hedging risks relating to their business.

(2) In particular, this chapter sets out the *FCA's* requirements and *guidance* in respect of ~~provisions derived from~~:

(a) ~~articles 57(1) and 57(6) of *MiFID*, which require it to establish limits, on the basis of a methodology determined by *ESMA*, on~~ the size of a net position which a *person* can hold, together with those held on the *person's* behalf at an aggregate group level, at all times, in *commodity derivatives* traded on *trading venues* ~~and *economically equivalent OTC contracts* to those *commodity derivatives*~~;

~~[**Note:** articles 3 and 4 of *MiFID RTS 21*]~~

(b) ~~article 57(8) of *MiFID*, which requires *MiFID investment firms* and *market operators* operating a *trading venue* which trades *commodity derivatives* to apply~~ position management controls in relation to the trading of commodity derivatives;

(c) ~~article 58(1) of *MiFID*, which requires~~ *MiFID investment firms* and *market operators* operating a *trading venue* which trades *commodity derivatives* or *emission allowances* ~~to provide the *competent authority* with~~ providing reports in respect of ~~such~~ positions held; and

(d) ~~article 58(2) of *MiFID*, which requires~~ *investment firms* trading in *commodity derivatives* or *emission allowances* outside a *trading venue* ~~to provide the *competent authority* with~~ providing reports containing a complete breakdown of their positions held through such contracts traded on a *trading venue* ~~and *economically equivalent OTC contracts*~~, as well as of those of their *clients* and the clients of those clients until the end client is reached.

(3) The position limit requirements apply to both *authorised persons* and *unauthorised persons*. As such, the *MiFI Regulations* provide for a separate regulatory framework in relation to such *persons*. This framework is set out in:

(a) …

(b) Schedule 1 to the *MiFI Regulations* ('Administration and enforcement of Part 3, 4 and 5'), which provides for the administration and enforcement of position limits established by the *FCA*, and of the reporting of positions in *commodity derivatives*~~,~~ and *emission allowances* ~~and *economically equivalent OTC contracts*~~.

~~This chapter complements and adds to the regulatory framework in the *MiFI Regulations* by establishing the applicable position limits.~~

Scope and territoriality

10.1.2 G (1) The scope of this chapter is as follows: In respect of position limit requirements in *MAR* 10.2, a *commodity derivative* position limit established by a *trading venue* in accordance with [*MAR* 10.2.1AR] or the *FCA* in accordance with *MAR* 10.2.2D(1) applies regardless of the location of the *person* at the time of entering into the position and the location of execution.

~~[**Note:** article 57(14)(a) of *MiFID*]~~

(2) In respect of position management controls requirements:

(a) the requirements contained or referred to in *MAR* 10.3 apply to UK *persons* operating a *trading venue* which trades *commodity derivatives* ~~in respect of which the *FCA* is the *competent authority*~~; and

(b) in the case of a *UK branch* of a *third country investment firm operating an MTF* or *OTF*, *MAR* 10.3 applies in the same way as it does to a *UK firm operating a multilateral trading facility* or an *OTF*.

…

Structure

10.1.3 G This chapter is structured as follows:

(1) *MAR* 10.1 sets out an introduction to *MAR* 10, a description of the application of *MAR* 10 to different categories of *person*~~, an explanation of the approach taken to the *UK* transposition of articles 57 and 58 of *MiFID*, the scope and territoriality of this chapter,~~ and the structure of this chapter.

(2) *MAR* 10.2 sets out the position limit requirements.

(3) *MAR* 10.3 sets out the position management controls requirements.

(4) *MAR* 10.4 sets out the position reporting requirements.

(5) *MAR* 10.5 sets out other reporting, notification and information requirements.

10.2 Position limit requirements

Establishing, applying and resetting position limits

10.2.1 G (1) The following provisions of the *MiFI Regulations* regulate the establishment, application and resetting of position limits:

(-a) Regulation 15A enables the *FCA* to require operators of *trading venues* to establish and apply:

(i) position limits in respect of specified *commodity derivatives*, or *commodity derivatives* of a specified class, that are traded on a *trading venue*; and

(ii) position management controls in relation to the trading of *commodity derivatives*.

(a) Regulation 16(1) ~~imposes an obligation on~~ enables the *FCA* to establish position limits in respect of *commodity derivatives* traded on *trading venues* in the *United Kingdom* ~~and *economically equivalent OTC contracts*~~; and

(b) ~~Regulation 16(2) imposes an obligation on the *FCA* to establish position limits on the basis of all positions held by a *person* in the contract to which the limit relates and those held on the *person's* behalf at an aggregate group level;~~ [deleted]

(c) Regulation 16(4) imposes an obligation on the *FCA* to publish the position limits it establishes in a manner which the *FCA* considers appropriate~~;~~.

(d) ~~Regulation 18 imposes an obligation on the *FCA* to ensure that each position limit established by it specifies clear quantitative thresholds for the maximum size of a position in a *commodity derivative* that a *person* can hold;~~ [deleted]

(e) ~~Regulation 19(1) imposes an obligation on the *FCA* to establish position limits in accordance with *ESMA's* methodology, unless an exceptional case exists under Regulation 25 of the *MiFI Regulations*;~~ [deleted]

(f) ~~Regulation 19(2) imposes an obligation on the *FCA* to review position limits it has established in the presence of certain factors;~~ [deleted]

(g) ~~Regulation 19(3) imposes an obligation on the *FCA* to establish a new position limit following its review if it believes that the limit should be reset;~~ [deleted]

…

(j) Regulation 23 imposes general obligations on the *FCA* in respect of the position limits it establishes, so that the limits must be transparent and non-discriminatory, specify how they apply to *persons*, and take account of the nature and composition of market participants and of the use they make of the contracts admitted to trading; and

(k) ~~Regulation 25(1) prohibits the *FCA* from establishing position limits which are more restrictive than permitted under *MiFID RTS 21* unless in exceptional cases where more restrictive position limits are objectively justified and proportionate;~~ [deleted]

(l) ~~Regulation 25(2) to Regulation 25(5) impose obligations on the *FCA* where it establishes position limits which are more restrictive than permitted under *MiFID RTS 21* in accordance with Regulation 25(1) of the *MiFI Regulations*. The obligations are that the *FCA* must publish that position limit on its website, and not apply that position limit for more than six *months* from the date of publication unless further subsequent six-*month* application periods for that limit are objectively justified and proportionate; and~~ [deleted]

…

(2) ~~*MiFID RTS 21* provides a methodology for the calculation of position limits on *commodity derivatives*, and rules for the calculation of the net position held by a *person* in a *commodity derivative*.~~ [deleted]

(3) ~~*MiFID RTS 21* provides that the *FCA* can establish different position limits for different times within the spot month period or other months' period of a *commodity derivative*, and for the spot month period, those position limits shall decrease towards the maturity of the *commodity derivative*, and shall take into account the position management controls of *trading venues*.~~ [deleted]

~~[**Note:** article 57 of *MiFID*]~~

Application of position limits

10.2.1A R A *trading venue operator* must establish a position limit in relation to:

(1) a *commodity derivative* listed in *MAR* 10 Annex 2 and traded on a *trading venue* it operates;

(2) any other contract which is critical to or significant for the purposes of the functioning of the *commodity derivatives* markets in the *UK*, having regard to its characteristics, including the criteria listed in *MAR* 10.2.1ER, when notified to do so by the *FCA*; and

(3) any *related contract* as part of the position limit it imposes for the purposes of *MAR* 10.2.1AR(1) and (2).

10.2.1B G When it considers that a contract other than one to which *MAR* 10.2.1AR(1) applies amounts to a *critical contact*, the *FCA* will notify market participants of this using a notice on its website at: [*Editor's note*: insert link] having had regard to:

(1) the risk to the settlement method at contract expiry;

(2) the size of the *commodity derivative* market compared with the underlying *commodity* and the robustness of the reference price used to settle contracts;

(3) the type of underlying and the impact on non-financial end-users; and

(4) the size of the market including factors such as *open interest*, traded volumes, and the number and variety of market participants.

10.2.1C G (1) For a period of at least 45 *days* beginning with the date on which the *FCA* publishes the notice in *MAR* 10.2.1BG, market participants can comment on the proposed determination by submitting a response to: [*Editor's note*: insert e-mail address/website].

(2) If, having considered market participants' responses, the *FCA* considers that a *commodity derivative* is a *critical contract*, it will publish the outcome of its consultation accordingly.

10.2.1D R A *trading venue operator* must establish and apply a position limit within 30 *days* of the publication in *MAR* 10.2.1CG(2) or within a *day* of the contracts being published on the *Financial Services Register*, whichever is the later.

10.2.1E R When setting a position limit in respect of a *critical contract*, a *trading venue operator* must have regard at least to:

(1) deliverable supply in the underlying *commodity*;

(2) aggregate *open interest* and its relationship with deliverable supply;

(3) maturity of the *critical contract*;

(4) volatility in the price of the *commodity derivative* and in the underlying *commodity*;

(5) liquidity, including:

(a) aggregate traded volumes of the *critical contract*, the underlying of the *critical contract*, *related contracts*, *related OTC contracts* and *related overseas commodity derivative contracts*; and

(b) the number, size and type of the market participants; and

(6) the ability of market participants to make or take delivery, and the characteristics of the underlying *commodity* market including transportation, delivery, storage and settlement of the *commodity*.

10.2.1F G (1) Where the deliverable supply in the underlying *commodity* can be restricted or controlled, or if the level of deliverable supply is low relative to the amount required for orderly settlement, the *trading venue operator* should adjust the position limit downwards. The *trading venue operator* should assess the extent to which this deliverable supply is used also as the deliverable supply for other commodity derivatives.

(2) Where there is a large volume of overall *open interest* or *open interest* is significantly higher than deliverable supply, the *trading venue operator* should adjust the position limit downwards. Where the *open interest* is significantly lower than the deliverable supply, the *trading venue operator* should adjust the position limit upwards.

(3) For *spot month contract* position limits, if the *commodity derivative* has a short maturity, the *trading venue operator* should adjust the position limit downwards. For *other months' contract* position limits, if the *commodity derivative* has a larger number of separate expiries, the *trading venue operator* should adjust the position limit upwards.

(4) A *trading venue operator* should consider the extent to which excessive volatility in the *commodity derivative* market and in the underlying *commodity* may impact the ability of market participants to unwind their positions in an orderly way.

10.2.1G G A *trading venue operator's* assessment of the underlying *commodity* market for the purposes of *MAR* 10.2.1FG(4) should include:

(1) the storage or settlement of the *commodity* having regard to its physical properties and any geopolitical factors where relevant;

(2) the method of transportation and delivery of the *commodity* including the capacity constraints of any specified delivery points;

(3) the structure, organisation and operation of the market including any seasonal fluctuations in physical supply;

(4) the number, size and type of market participants providing risk management, delivery, storage, settlement and any other key services; and

(5) the size of positions held by market participants over a period of time relative to stock availability in the underlying *commodity*.

10.2.1H R (1) A *trading venue operator* must apply its position limits in respect of *critical contracts* to:

(a) *spot month contracts* and *other months' contracts* separately; and

(b) the net positions held by a *person*, together with those held on its behalf, at an aggregate group level.

(2) A *trading venue operator* must require that a *person* determine separately the net position it holds in a *commodity derivative* for both *spot month contracts* and *other months' contracts*.

(3) A *trading venue operator* must require that:

(a) where a *person* holds both long and short positions in any *critical contracts* or *related contracts* the *person* net those positions (and no other positions in other *commodity derivatives*) to determine its net position other than where *MAR* 10.2.1HR(4) applies;

(b) a position to which an exemption in *MAR* 10.2 applies is not aggregated for the purposes of *MAR* 10.2.1HR(1)(b);

(c) a *parent undertaking* determines its net position by aggregating its own net position and the net positions of each of its *subsidiary undertakings* except where *MAR* 10.2.1HR(3)(d) applies; and

(d) the *parent undertaking* of a *manager* of a collective investment undertaking must not aggregate the positions in *commodity derivatives* in any collective investment undertaking where it does not in any way influence the investment decisions in respect of opening, holding or closing those positions.

(4) A *trading venue operator* must not permit the netting of positions in relation to a *related contract* where it considers this will increase the likelihood of disorderly pricing or settlement conditions.

(5) Where *MAR* 10.2.1HR(4) applies, a *trading venue operator* must inform the relevant members, participants or clients, and describe how their positions should be aggregated for the purposes of discharging their obligation to meet the position limit imposed by the *trading venue operator* in accordance with *MAR* 10.2.1AR.

10.2.1I R A *trading venue operator* must:

(1) publish its position limits and apply these on a non-discriminatory basis;

(2) maintain arrangements designed to enable it to determine and ensure position limits relating to a *critical contract* traded on its *trading venue* are complied with by *persons* at all times regardless of the location of the *person* at the time of entering into the position;

(3) ensure the position limits on a *trading venue* it operates remains appropriate at all times;

(4) review its position limits at least once every year and whenever there is a significant change in deliverable supply or *open interest*, or which significantly impacts the commodity derivatives market;

(5) establish and maintain a methodology for applying position limits in respect of *critical contracts*;

(6) notify the *FCA* prior to imposing a position limit unless it is not reasonably practicable to do so; and

(7) publish a consultation prior to setting or modifying a position limit unless it is not reasonably practicable to do so, in accordance with its rules.

10.2.1J G (1) A *trading venue operator* should consider whether to apply multiple limits to *spot month contracts* and *other months' contracts* in respect of *critical contracts* when discharging their obligations under *MAR* 10.2.1AR.

(2) A *trading venue operator* should have regard, as applicable, to:

(a) *recognition requirements* including systems and controls, internal audit, ensuring orderly markets and promotion, and maintenance of standards; or

(b) *common platform requirements*,

when developing methodologies for setting position limits.

10.2.2 D (1) A *person* must comply at all times with *commodity derivative* position limits established by the *FCA*, published at www.fca.org.uk.

(2) A direction made under (1) applies where a *commodity derivative* is traded on a *trading venue* in the United Kingdom.

(3) Position limits established under (1) shall apply to the positions held by a *person* together with those held on its behalf at an aggregate group level ~~(subject to the *non-financial entity* exemption in regulation 17(1) of the *MiFI Regulations*)~~.

(4) Position limits established under (1) shall apply regardless of the location of the *person* at the time of entering into the position.

(5) ~~Position limits established under (1) prior to 3 January 2018, will apply from 3 January 2018.~~ [deleted]

~~[**Note**: articles 57(1) and 57(14) of *MiFID*; and *MiFID RTS 21* in respect of *ESMA's* methodology for *competent authorities* to calculate position limits]~~

10.2.2A G The *FCA* may exceptionally, by giving directions, establish position limits in respect of *commodity derivatives* to which position limit requirements imposed by *trading venues* apply.

~~Non-financial entity exemption~~ Position limits exemptions

10.2.3 G (1) ~~Regulation 17 of the *MiFI Regulations* regulates the position limit exemption applicable to positions in a *commodity derivative* held by or on behalf of a *non-financial entity* which are objectively measurable as reducing risks directly relating to the commercial activity of that *non-financial entity*, and which is approved by the *FCA* in accordance with the relevant criteria and procedures. Regulation 17(1) imposes an obligation on the *FCA* to disregard such positions, when calculating the position held by such entities in respect of a *commodity derivative* to which a position limit applies.~~ [deleted]

(2) ~~Regulation 17(2) of the *MiFI Regulations* enables the *FCA* to receive applications from *non-financial entities* for the purposes of obtaining an exemption from the position limits which it sets and in such form as the *FCA* may direct.~~ [deleted]

(3) ~~*MiFID RTS 21* stipulates detail on positions qualifying as reducing risks directly related to commercial activities, and the application for the exemption from position limits.~~ [deleted]

(4) ~~*MiFID RTS 21* clarifies that a *non-financial entity* shall notify the *FCA* if there is a significant change to the nature or value of that *non-financial entity's* commercial activities, or its trading activities in~~

~~*commodity derivatives*. The obligation arises where the change is relevant to the description of the nature and value of the *non-financial entity's* trading and positions held in *commodity derivatives* and their *economically equivalent OTC contracts* in a position limit exemption application it has already submitted. In this case, a *non-financial entity* must submit a new application if it intends to continue to make use of the exemption.~~ [deleted]

~~[**Note:** article 57(1) of *MiFID*]~~

10.2.3A G A *trading venue operator* can receive applications from *non-financial entities* and *financial entities* for the purposes of obtaining an exemption from the position limits it sets. The different types of exemptions and relevant criteria and procedures are set out in *MAR* 10.2.6R to *MAR* 10.2.26G.

Non-financial entity exemption application

10.2.4 D ~~A *non-financial entity* must complete the application form in *MAR* 10 Annex 1D for approval to be exempt from compliance with position limits established by the *FCA* in accordance with *MAR* 10.2.2D(1).~~ [deleted]

10.2.5 G …

10.2.6 R A *trading venue operator* may determine that *a non-financial entity's* position for the purposes of a position limit does not include a position it holds, or one held on its behalf which is:

(1) objectively measurable as reducing risks directly relating to its commercial activity; and

(2) approved by the *trading venue operator* setting the position limit in accordance with:

(a) the relevant criteria and methods in *MAR* 10.2.7R; and

(b) the relevant procedure in *MAR* 10.2.8R to *MAR* 10.2.10R.

10.2.7 R (1) A *trading venue operator* may make the determination in *MAR* 10.2.6R where it is satisfied that the following criteria are met:

(a) a position held by a *non-financial entity*:

(i) reduces the risks arising from the potential change in the value of assets, services, inputs, products, commodities or liabilities that the *non-financial entity* or its group owns, produces, manufactures, processes, provides, purchases, merchandises, leases, sells, or incurs or reasonably anticipates owning, producing, manufacturing, processing, providing, purchasing, merchandising, leasing, selling or incurring in the normal course of its business; or

(ii) qualifies as a hedging contract pursuant to *UK-adopted IFRS*; and

(b) a *non-financial entity's* position, at its estimated highest point in the following year can be unwound, in particular during times of market stress where market liquidity may be constrained, in a way that does not impair orderly markets.

10.2.8 R When making a determination in accordance with *MAR* 10.2.6R, a *trading venue operator* must require a *non-financial entity* to submit to it at least the following information, at the time of its application and in relation to the following 12 *months*, which demonstrates how the position reduces risks directly relating to the *non-financial entity's* commercial activity:

(1) a description of the nature and value of the *non-financial entity's* commercial activities in the *commodity* underlying the *commodity derivative* for which an exemption is sought;

(2) a description of the nature and value of the *non-financial entity's* activities in the trading of and positions held in the relevant *commodity derivatives* traded on *trading venues* and in *related OTC contracts*;

(3) a description of the nature and size of the exposures and risks in the *commodity* which the *non-financial entity* has or expects to have as a result of its commercial activities and which are or would be mitigated by the use of commodity derivatives;

(4) an explanation of how the *non-financial entity's* use of commodity derivatives directly reduces its exposure and risks in its commercial activities; and

(5) information regarding the *non-financial entity's* ability to unwind its positions at their highest point in the following year, including during times of market stress, in a way that does not impair orderly markets.

10.2.9 R A qualifying risk-reducing position taken on its own or in combination with other derivatives is one, for the purposes of *MAR* 10.2.6R, for which the *non-financial entity*:

(1) describes the following in its internal policies:

(a) the types of commodity derivative contract included in the portfolios used to reduce risks directly relating to commercial activity and their eligibility criteria;

(b) the link between the portfolio and the risks that the portfolio is mitigating; and

(c) the measures adopted to ensure that the positions concerning those contracts serve no other purpose than covering risks directly related to the commercial activities of the *non-financial entity*, and that any position serving a different purpose can be clearly identified; and

(2) is able to provide a sufficiently disaggregated view of the portfolios in terms of class of commodity derivative, underlying *commodity*, time horizon and any other relevant factors.

10.2.10 R A *trading venue operator* must require a *non-financial entity* to notify it:

(1) promptly if there is a significant change to the nature or value of the *non-financial entity's* commercial activities or its trading activities in *commodity derivatives*, and the change is relevant to the information required in *MAR* 10.2.8R;

(2) promptly of a breach of any condition relating to an exemption; and

(3) in any event, on an annual basis, of its intention to rely on the exemption or otherwise, and supplying any changes to the information previously submitted in accordance with *MAR* 10.2.8R.

10.2.11 R A *trading venue operator* must notify the *FCA*:

(1) promptly of an exemption granted to a *non-financial entity* in accordance with *MAR* 10.2.6R, including any conditions such as an *exemption ceiling* attached to the exemption; and

(2) on an annual basis of all exemptions from position limits granted by it to *non-financial entities*.

10.2.12 R A *trading venue operator* must review exemptions from position limits granted to *non-financial entities*:

(1) at least on an annual basis; and

(2) whenever it receives a notification as described in *MAR* 10.2.10R.

Pass-through hedging exemption

10.2.13 R A *trading venue operator* may determine that a *financial entity's* position for the purposes of a position limit does not include a position it holds or one held on its behalf for the purposes of enabling a *non-financial entity* to benefit from the *hedging exemption*.

10.2.14 R A *trading venue operator* may determine that a *financial entity's* (A's) position for the purposes of a position limit does not include a position it holds or one held on its behalf when it:

(1) arises under a *commodity derivative* traded on a *trading venue*; and

(2) is entered into by A on a *trading venue* for the purpose of off-setting the risk arising from a contract with a *non-financial entity* (B) facilitating hedging activity by B.

10.2.15 R A *trading venue operator* may only make the determination with regard to *MAR* 10.2.14R when a *financial entity* has obtained written confirmation from a *non-financial entity* that the position entered into for the purposes of *MAR* 10.2.14R(2) qualifies as a hedging contract under a *hedging exemption*.

10.2.16 R When making a determination in accordance with *MAR* 10.2.13R or *MAR* 10.2.14R, a *trading venue operator* must require a *financial entity* to submit to it at least the following information at the time of its application and where possible in relation to the following 12 *months*:

(1) the nature and value of the *financial entity's* risk-mitigation services in the *commodity* underlying the *commodity derivative* for which an exemption is applied; and

(2) the nature and value of the *financial entity's* trading activity and positions in *commodity derivatives* for which an exemption is applied, including in *OTC commodity derivatives* that relate to providing risk-mitigation services.

10.2.17 R A *trading venue operator* must require a *financial entity* to notify it:

(1) promptly if there is a significant change relevant to the information set out in *MAR* 10.2.16R; and

(2) on an annual basis of its intention to rely on the exemption or otherwise, and supplying any changes to the information previously submitted in accordance with *MAR* 10.2.16R, including information relating to the period for the next 12 *months*.

10.2.18 R A *trading venue operator* must notify the *FCA*:

(1) promptly of an exemption granted to a *financial entity* in accordance with *MAR* 10.2.13R or *MAR* 10.2.14R, including any conditions such as an *exemption ceiling* attached to the exemption; and

(2) on an annual basis of all exemptions from position limits granted by it to *financial entities*.

10.2.19 R A *trading venue operator* must review all exemptions from position limits granted to *financial entities*;

(1) at least on an annual basis; and

(2) whenever it receives a notification as described in *MAR* 10.2.17R(1).

Liquidity provider exemption

10.2.20 R A *trading venue operator* may determine that a position limit does not apply to a position held by a *person* for a position that is objectively measurable as resulting from a *transaction* consistent with obligations to provide liquidity on a *trading venue*.

10.2.21 R A *trading venue operator* may make the determination in *MAR* 10.2.20R where:

(1) it receives an application from a *person* for these purposes;

(2) the obligations to provide liquidity are clearly defined and relate to observable metrics of market quality, including depth and tightness of the spread;

(3) the position arises from discharge of the *person's* obligation as a liquidity provider; and

(4) the exemption is temporary in duration and the *person* reduces its position as soon as reasonably practicable prior to the expiry of the contract providing liquidity on the *trading venue*.

10.2.22 R A *trading venue operator* must ensure that an application for the purposes of *MAR* 10.2.21R provide as a minimum:

(1) an overview of the liquidity it provides in respect of the *commodity derivatives* for which an exemption from a position limit is being requested; and

(2) current and anticipated trading for the following year in respect of the *commodity derivatives* for which it is providing liquidity for the purposes of this exemption.

10.2.23 R A *trading venue operator* must notify the *FCA*;

(1) promptly of an exemption granted to it in accordance with *MAR* 10.2.20R, including any conditions such as an *exemption ceiling* attached to the exemption; and

(2) on an annual basis of all exemptions from position limits granted by it to in accordance with *MAR* 10.2.20R

All exemptions

10.2.24 R A *trading venue operator* must:

(1) provide the *FCA*, upon request, with such information as the *FCA* may reasonably require to enable a fuller understanding of the basis for granting an exemption to which *MAR* 10.2 applies;

(2) store information in an easily retrievable way that is accessible for future reference by the *FCA* for the purposes of *MAR* 10.2.24R(1); and

(3) ensure that its systems can identify:

(a) when an exemption under *MAR* 10.2 is being used in relation to a market participant's position in a *commodity derivative*; and

(b) which exemption is being used.

10.2.25 R (1) A *trading venue operator* may impose an *exemption ceiling* for the purposes of any of the exemptions in *MAR* 10.2.

(2) A *trading venue operator* must explain in its rules how it will apply and determine an *exemption ceiling*, including how and when it may be amended.

(3) Where an *exemption ceiling* is breached, a *trading venue operator* must report to the *FCA* the breach and steps taken following the breach.

10.2.26 G The use of an *exemption ceiling* can enable a *trading venue* to function more effectively, including by mitigating the risk of *market abuse* and supporting orderly pricing and settlement conditions.

10.3 Position management controls

Application

10.3.1 G ~~The application of this section is set out in the following table:~~ [deleted]

~~**Type of firm**~~	~~**Applicable provisions**~~
~~a *UK market operator* operating a *trading venue*~~	~~*MAR* 10.3.2G and *MAR* 10.3.4G~~
~~a *UK firm operating a multilateral trading facility* or an *OTF* and a *UK branch* of a *third country investment firm operating a multilateral trading facility* or an *OTF*~~	~~*MAR* 10.3.3R to *MAR* 10.3.5G~~

Position management controls applicable to UK market operators operating a trading venue

10.3.2 G ~~A *UK market operator* operating a *trading venue* which trades *commodity derivatives* must apply position management controls on that *trading venue*,~~

~~in accordance with paragraph 7BA of the Schedule to the *Recognition Requirements Regulations*, as inserted by the *MiFI Regulations*.~~ [deleted]

~~[**Note:** article 57(8) to 57(10) of *MiFID*]~~

10.3.2A R A *UK market operator* is subject to *MAR* 10.3.3R as if it were a *UK firm operating a multilateral trading facility* or an *OTF* and references to an *MTF* are to a *regulated market* or an *MTF* that it operates.

Position management controls applicable to UK firms and UK branches of third country investment firms operating an MTF or OTF

10.3.3 R …

~~[**Note:** article 57(8) to 57(10) of *MiFID*]~~

Accountability thresholds, additional reporting and risk framework

10.3.3A R (1) A *trading venue operator* must apply additional position management controls in relation to the *critical contracts* and *related contracts* traded on its systems:

(a) ensuring the effective and timely identification of substantial positions, including positions subject to an exemption referred to in *MAR* 10.2;

(b) setting *accountability thresholds* below position limits enabling early identification of build-up of positions and risk of breaching a position limit; and

(c) taking steps to manage excessive or unjustified positions, including reducing or terminating these where a *person* fails to comply with a request to manage their positions further to breach of *accountability thresholds*, *exemption ceilings* or otherwise.

(2) A *trading venue operator* must ensure that its *accountability thresholds* are adequate, transparent, non-discriminatory, clear and accessible to market participants, at all times. It must also specify how the controls apply to *persons*.

(3) A *trading venue operator* must keep the adequacy of its *accountability thresholds* under review on a regular basis and notify the *FCA* promptly of these reviews, including:

(a) whenever there is a significant change to either the position limit or one or more of the factors in *MAR* 10.3.3BR; and

(b) at least on an annual basis.

(4) A *trading venue operator* must explain when notifying the *FCA* in accordance with *MAR* 10.3.3AR(3):

(a) how it had regard to the criteria in *MAR* 10.3.3BR; and

(b) the relationship between the *accountability threshold* and corresponding position limit.

(5) A *trading venue operator*, for the purposes of its annual notification under *MAR* 10.3.3AR(3)(b), must inform the *FCA* of:

(a) how many times a threshold to which *MAR* 10.3.3AR(1)(b) applies has been exceeded including the duration of each breach;

(b) the identity of the market participant; and

(c) the steps then taken by the *trading venue operator* to address the risks identified.

(6) A *trading venue operator* must identify the *related contracts*, *related OTC contracts* and *related overseas commodity derivative contracts* relevant to the position management in respect of *critical contracts* traded on a *trading venue* it operates.

(7) A *trading venue operator* may have regard to the underlying objective of supporting orderly pricing and settlement conditions when identifying a *related contract* for the purposes of setting and monitoring position limits under *MAR* 10.2.

10.3.3B R A *trading venue operator*, when setting *accountability thresholds*, must establish a methodology that has regard at least to:

(1) its position limit, factors determining the position limit and the need to ensure increasing positions can be investigated before risks crystallise;

(2) whether the volume and any required remedial action of *accountability threshold* excesses indicates that the control is effective in providing early warning of prospective position limit breaches and enabling action; and

(3) market concentration and concentrated trading activity.

10.3.3C R (1) A *trading venue operator* must develop a risk assessment framework to enable it to discharge its obligations under *MAR* 10.3.3AR.

(2) The risk assessment framework must have regard at least to:

(a) exemptions determined in accordance with *MAR* 10.2, including any conditions attaching to exemptions in the form of *exemption ceilings* or otherwise;

(b) *accountability thresholds*;

(c) whether a *person* otherwise holds a concentrated position in the physical or *commodity derivatives* markets which presents a material risk to the functioning of a *commodity derivatives* market, including the risk of *market abuse* and to orderly pricing and settlement conditions; and

(d) the factors in *MAR* 10.3.3BR.

10.3.3D R (1) A *trading venue operator* must require *additional reporting* to it by a member or participant (A) acting on its behalf or on behalf of a client (B) when A or B's positions together with those held on their behalf:

(a) in a *critical contract* and any *related contract*; and

(b) at an aggregate group level including any positions subject to an exemption under *MAR* 10.2,

are equal to or exceed an *accountability threshold* required by *MAR* 10.3.3AR(1)(b) or a threshold at which an *exemption ceiling* applies.

(2) When *MAR* 10.3.3DR(1) applies, a *trading venue operator* must require A to report the information required in *MAR* 10.3.3ER:

(a) for a period specified by the *trading venue operator* which is appropriate to the risks posed by the position in the market but at least as long as the *person's* position above the *accountability threshold* or an *exemption ceiling*; or

(b) until the *person's* position is below the threshold:

(i) at which a *trading venue's accountability thresholds* apply in accordance with *MAR* 10.3.3AR(1)(b); or

(ii) at which an *exemption ceiling* applies.

(3) When *MAR* 10.3.3DR(2)(a) applies, a *trading venue operator* must record this and notify the *FCA* in accordance with *MAR* 10.3.3AR(5).

10.3.3E R (1) A *trading venue operator* may require that additional information relating to the price or delivery of a *critical contract* or *related contract* form part of *additional reporting* when *MAR* 10.3.3DR applies, including at least:

(a) *related OTC contracts* positions;

(b) *related overseas commodity derivative contracts* positions;

(c) where relevant, trades in the underlying *commodity* of the *critical contract*;

(d) where relevant, trades used to settle *commodity futures*; and

(e) where relevant, inventories, storage and infrastructure integrity at locations where deliveries are made.

(2) A *trading venue operator* must seek information about inventory, storage and infrastructure integrity from other data sources in addition to the position holder subject to *additional reporting* imposed further to *MAR* 10.3.3DR.

(3) A *trading venue operator* must inform its members, participants or clients of *related overseas commodity derivative contracts* and *related OTC contracts* to which *additional reporting* can apply.

10.3.3F G As part of discharging its obligation under *MAR* 10.3.3ER(1)(a), a *trading venue operator* may rely on information which it already has, in the case of *over the counter derivative* contracts, as a result of services provided otherwise than in the operation of a *trading venue*.

10.3.3G R When *MAR* 10.3.3DR applies, a *trading venue operator* must consider the following factors as part of its monitoring and oversight:

(1) historic and anticipated position sizes and risk management capabilities of the individual markets or participants;

(2) the extent and quality of the individual member or participant's engagement with the *trading venue operator* and response to its inquiries;

(3) where a contract is physically deliverable, the complexity of the delivery process and a position holder's expertise in taking delivery of the underlying *commodity*; and

(4) how an individual member or participant's positions compare with other position holders, including in particular peers.

10.3.3H R (1) A *trading venue operator* must use the information in *MAR* 10.3.3AR and the reported information in *MAR* 10.4 to perform market risk analysis.

(2) The market risk analysis must include at least:

(a) an identification of risks arising from the underlying physical *commodity*, *related over the counter* and *related overseas commodity derivative contracts* markets in relation to their impact on *commodity derivatives* traded on a *trading venue* it operates; and

(b) how the risks in *MAR* 10.3.3AR are being managed by the *trading venue operator*.

(3) As part of its market risk analysis, a *trading venue operator* must consider whether regular or periodic systematic reporting requirements relating to *over the counter derivatives* are necessary to support their general monitoring of the orderliness of those markets

(4) A *trading venue operator* must:

(a) make available its market risk analysis to the *FCA* on a regular basis and upon request, data underlying the analysis.

(b) store information in an easily retrievable way that is accessible for future reference by the *FCA* for the purposes of *MAR* 10.3.3HR(4)(a).

(5) A *trading venue operator* must make available its market risk analysis to the *FCA*:

(a) whenever there is a significant change in market risk, having regard size or concentration of positions, settlement or delivery and underlying *commodity* markets; and

(b) at least on an annual basis.

10.3.3I G For the purposes of *MAR* 10.3.3HR, a risk-sensitive market analysis may indicate the need for a broader and more regular set of trading data – for example, where the related *over the counter* market is assessed as accounting for a large proportion of the market for the relevant *commodity derivatives*.

Supervision of position management controls

10.3.4 G (1) ~~An operator of a *trading venue*~~ A *trading venue operator* ~~referred to in *MAR* 10.3.1G~~ may include provisions in its rulebook which impose appropriate obligations on its members or participants as part of compliance with its position management controls obligations, including in relation to *accountability thresholds* and *additional reporting*.

(2) A *trading venue operator* may require, via its rulebook or otherwise, other further reporting by a member or participant acting on its behalf or on behalf of a client, as well as in the circumstances to which *additional reporting* applies. This includes imposing a responsibility on members to put arrangements in place with clients, enabling ready access to data at the level of the client.

10.3.4A R A *trading venue operator* must notify the *FCA* prior to implementation of each of the following and their subsequent modification:

(1) the risk assessment framework in *MAR* 10.3.3CR, *additional reporting* and market risk analysis;

(2) *accountability thresholds*;

(3) governance arrangements to be followed for adoption and continuing review of position limit setting, the risk assessment framework, *accountability thresholds* and market risk analysis, including allocation of senior management responsibility, policies for managing conflicts, systems and controls, and board oversight;

(4) the methodology for and setting of position limits and *accountability thresholds*, including the identification of *related contracts* and positions not eligible for netting.

(5) the list of *related contracts*, *related OTC contracts* and *related overseas commodity derivative contracts*;

(6) policies and procedures relating to:

(a) the granting of exemptions in *MAR* 10.2, including the approach to the setting of *exemption ceilings*; and

(b) position limit breaches including resolution and access to enforcement tools; and

(7) arrangements for the sharing of information with relevant *CCPs*.

10.3.4B G When a *trading venue operator* notifies the *FCA* in accordance with *MAR* 10.3.4AR, it should allow such time as is necessary for the *FCA* to consider and assess the relevant matters, prior to proposed implementation.

~~Position management controls: Procedure for informing the FCA~~ [deleted]

10.3.5 ~~G~~ ~~A *firm* must comply with the obligation in *MAR* 10.3.3R(4) by completing the form available at www.fca.org.uk.~~ [deleted]

10.3.6 G A *trading venue operator* should have regard, as applicable, to:

(1) *recognition requirements* including systems and controls, internal audit, ensuring orderly markets and promotion, and maintenance of standards; or

(2) *common platform requirements*,

when developing *accountability thresholds* and applying *additional reporting*, as well as when granting exemptions in accordance with *MAR* 2.

10.3.7 G A *trading venue operator* should establish notification and information sharing arrangements with *CCPs* clearing transactions executed on the *trading venues* it operates, in particular when it identifies potential concerns regarding concentration risk or funding liquidity risk, as part of the application for exemption process or as a result of *additional reporting*.

10.4 Position reporting

Application

10.4.1 G The application of this section is set out in the following table:

Type of firm	Applicable provisions
Regulated market	*MAR* 10.4.1AR to *MAR* 10.4.1DR, *MAR* 10.4.2G and *MAR* 10.4.3AR
UK firm operating a multilateral trading facility or an *OTF* and a *UK branch* of a *third country investment firm operating a multilateral trading facility* or an *OTF*	*MAR* 10.4.1AR to *MAR* 10.4.1DR and *MAR* 10.4.3R to *MAR* 10.4.6G
…	

Position reporting by trading venue operators

10.4.1A R A *trading venue operator* must send the *FCA* a *weekly report* regarding the aggregate positions held at the close of business of each week, no later than 5.30pm on Wednesday of the following week.

10.4.1B R A *trading venue operator* must submit a *weekly report* to the *FCA* as soon as possible and no later than 5.30pm on Thursday of that week, where any of Monday, Tuesday or Wednesday of the week in which that report is to be submitted is not a *working day*.

10.4.1C R (1) A *trading venue operator* must prepare a *weekly report* separately for each *commodity derivative* and *emission allowance* traded on its *trading venue* in accordance with the formats set out in the tables in *MAR* 10 Annex 2.

(2) A *weekly report* must contain:

(a) the aggregate of all positions held by the different *persons* in each of the categories set out in *MAR* 10 Annex 3 in an individual *commodity derivative* or *emission allowance* traded on that *trading venue*; and

(b) all positions across all maturities of all contracts.

(3) A *trading venue operator* must submit to the *FCA* a *weekly report* in a common standard XML format.

10.4.1D R A *trading venue operator* must submit to the *FCA* a breakdown of the positions referred to in *MAR* 10.4.8D by means of a daily position report in:

(1) common standard XML format; and

(2) the format set out in the tables in *MAR* 10 Annex 4.

Position reporting by UK regulated markets

10.4.2 G …

~~[**Note:** article 58(1) of *MiFID*]~~ [deleted]

Position reporting by UK firms and UK branches of third country investment firms operating an MTF or OTF: Reports

10.4.3 R (1) …

(2) A *firm* must make public and provide to the *FCA* a ~~weekly report~~ *weekly report* with the aggregate positions held by the different categories of *persons* for the different *commodity derivatives* or *emission allowances* traded on the *trading venue*, where those instruments meet the criteria of ~~article 83 of the *MiFID Org Regulation*~~ *MAR* 10.4.3AR, specifying:

(a) the number of long and short positions held by such categories;

(b) changes in those positions since the previous report;

(c) the percentage of the total open interest represented by each category; and

(d) the number of *persons* holding a position in each category, as specified in *MAR* 10.4.4R.

(3) The *firm* must provide the *FCA* with a complete breakdown of the positions held by all *persons*, including the members or participants and *clients*, as well as those of their clients until the end client is reached, on the *trading venue* on a daily basis.

(4) For the ~~weekly report~~ *weekly report* mentioned in (2) above, the *firm* must differentiate between:

(a) positions which ~~in an objectively measurable way reduce risks directly relating to commercial activities~~ are subject to the exemptions in *MAR* 10.2, identifying the relevant exemption by reference to the *non-financial entity*, pass-through hedging or liquidity provider exemption, as applicable; and

(b) other positions.

~~[**Note:** article 58(1) of *MiFID*, *MiFID ITS 4*, on position reporting and *MiFID ITS 5* on the format and timing of weekly position reports]~~

10.4.3A R (1) For the purpose of *weekly reports*, the obligation for a *trading venue operator* to make public such a report applies when both of the following 2 thresholds are met:

(a) 20 open position holders exist in a given contract on a given *trading venue*; and

(b) the absolute amount of the gross long or short volume of total *open interest*, expressed in the number of lots of the relevant *commodity derivative*, exceeds a level of 4 times the deliverable supply in the same *commodity derivative*, expressed in number of lots.

(2) Where the *commodity derivative* does not have a physically deliverable underlying asset and for *emission allowances*, *MAR* 10.4.3AR(1)(b) does not apply.

(3) The threshold set out in *MAR* 10.4.3AR(1)(a) applies in aggregate on the basis of all of the categories of *persons* regardless of the numbers of position holders in any single category of *persons*.

(4) For contracts where there are fewer than 5 position holders active in a given category of *persons*, the number of position holders in that category need not be published.

(5) For contracts that meet the conditions set out *MAR* 10.4.3AR(1) for the first time, *trading venues* must publish the contracts' first *weekly report* as soon as it is feasibly practical, and in any event no later than 3 weeks from the date on which the thresholds are first triggered.

(6) Where the conditions set out in *MAR* 10.4.3AR(1) are no longer met, *trading venues* must continue to publish the *weekly reports* for a period of 3 *months*. The obligation to publish the *weekly report* no longer applies where the conditions set out in *MAR* 10.4.3AR(1) have not been met continuously upon expiry of that period.

Position reporting by UK firms and UK branches of third country investment firms operating an MTF or OTF: classification of persons holding positions in commodity derivatives or emission allowances

10.4.4 R …

~~[**Note:** article 58(4) of *MiFID*]~~

Position reporting by UK firms and UK branches of ~~a~~ third country investment firms operating an MTF or OTF: Procedure for reporting to the FCA

10.4.5 D (1) …

(2) A *firm* shall report to the *FCA*:

(a) (where it meets the minimum threshold as specified in ~~article 83 of the *MiFID Org Regulation*~~ [*MAR* 10.4.3AR] the ~~weekly report~~ *weekly report* referred to in *MAR* 10.4.3R(2), by using the form set out in ~~Annex I of *MiFID ITS 4*~~ [*MAR* 10 Annex 3], and publish it on its website; and

(b) in respect of the daily report referred to in *MAR* 10.4.3R(3):

(i) by using the form set out in ~~Annex II of *MiFID ITS 4* available~~ [*MAR* 10 Annex 4] at https://www.fca.org.uk/markets/mifid-ii/commodity-derivatives; and

(ii) in each case, the report must be provided to the *FCA* by ~~21:00 GMT~~ 9pm the following *business day*.

~~[**Note:** *MiFID ITS 4* on position reporting]~~

Position reporting by UK firms and UK branches of ~~a~~ third country investment firms operating an MTF or OTF~~: Duplication of reporting~~

10.4.6 G For the purposes of making the ~~weekly report~~ *weekly report* referred to under *MAR* 10.4.3R(2), the *FCA* will accept an email containing a link to the report, as published on the *firm's* website. Emails should be sent to the *FCA* at COT_reports@fca.org.uk.

Position reporting by members, participants or clients of UK trading venues: trading venue participant reporting

10.4.7 D …

~~[**Note:** article 58(3) of *MiFID*]~~

MiFID investment firms and UK branches of third country investment firms: ~~OTC~~ reporting to the FCA

10.4.8 D …

(2) An *investment firm* in (1) trading in a *commodity derivative* or *emission allowance* outside a *trading venue* must, where the *FCA* is

the *competent authority* of the *trading venue* where that *commodity derivative* or *emission allowance* is traded, provide the *FCA* with a report containing a complete breakdown of:

(a) their positions taken in those *commodity derivatives* or *emission allowances* traded on a *trading venue*; and

(b) ~~*economically equivalent OTC contracts*; and~~ [deleted]

(c) the positions of their *clients* and the clients of those clients until the end client is reached, in accordance with article 26 of *MiFIR*.

(3) The report in (2) must be submitted to the *FCA*, for each *business day*, by ~~21:00 GMT~~ 9pm the following *business day*, using the form set out in ~~Annex II of *MiFID ITS 4*~~ *MAR* 10 Annex 4 available at https://www.fca.org.uk/markets/mifid-ii/commodity-derivatives.

(4) ~~The obligation in (2) does not apply where there is a *central competent authority* for the *commodity derivative* other than the *FCA*.~~ [deleted]

~~[**Note:** 58(2) of *MiFID*, and *MiFID ITS 4* on position reporting]~~

EEA MiFID investment firms who are members, participants or clients of UK trading venues: trading venue participant report and OTC reporting to the FCA

10.4.11 G …

(2) A *firm* subject to *MAR* 10.4.8D(2) may use a third party technology provider to submit to the *FCA* the report referred to in *MAR* 10.4.8 D(2) provided that it does so in a manner consistent with *MiFID*. It will retain responsibility for the completeness, accuracy and timely submission of the report and should populate field 5 of ~~*MiFID ITS 4* Annex II~~ *MAR* 10 Annex 4 Table 2 with its own reporting entity identification. It should be the applicant for, and should complete and sign, the *FCA MDP on-boarding application form*.

…

(4) A *firm* subject to *MAR* 10.4.8D(2) may arrange for the *trading venue* where that *commodity derivative* or *emission allowance* is traded to provide the *FCA* with the report provided that it does so in a manner consistent with *MiFID*. The *firm* will retain responsibility for the completeness, accuracy and timely submission of the report, submitted on its behalf. The *firm* should populate field 5 of ~~*MiFID ITS 4* Annex II~~ [*MAR* 10 Annex 4 Table 2] with its own reporting entity identification.

10.5 Other reporting, notifications and information requirements

Information requirement

10.5.1 G Regulation 27 of the *MiFI Regulations* provides the *FCA* with the power to:

…

(2) require an operator of a *trading venue* to provide information including all relevant documentation on, or concerning~~,~~:

(a) trades a *person* has undertaken, or intends to undertake in a contract to which a position limit relates~~.~~; and

(b) trades a *person* has undertaken, or intends to undertake in a contract or within a class of *commodity derivatives* to which position management requirements relate.

~~[**Note:** article 69(2)(j) of *MiFID*]~~

Power to intervene

10.5.2 G The following provisions of the *MiFI Regulations* regulate the power of the *FCA* to intervene in respect of position limits:

(1) Regulation 28 provides that the *FCA* may, if it considers necessary for the purpose of advancing one or more of its *operational objectives*, limit the ability of any *person* to enter into a contract for a *commodity derivative*, restrict the size of positions a *person* may hold in such a contract, or require any *person* to reduce the size of a position held, notwithstanding that the restriction or reduction would be more restrictive than the position limit established by the *trading venue* or the *FCA* ~~in accordance with article 57 of *MiFID* to which the contract relate~~s (under regulation 16 of the *MiFI Regulations*); and

…

~~[**Note:** article 69(2)(o) and 69(2)(p) of *MiFID*]~~

Reporting requirements

10.5.3 G The following provisions of the *MiFI Regulations* regulate the power of the *FCA* to impose reporting requirements in respect of positions taken in *commodity derivatives* and *emission allowances*:

…

~~[**Note:** article 69(2)(j) of *MiFID*]~~

…

~~Notifications by unauthorised persons: non-financial entity exemption applications~~

10.5.5	G	~~*SUP* 15.3.13G and *SUP* 15.3.14G apply to notifications of an application by an *unauthorised person* for the *non-financial entity* exemption under regulation 17 of the *MiFI Regulations* as if the *person* is a *firm* to which *SUP* 15.3.11R applies.~~ [deleted]

…

Territoriality

10.5.7	G	The powers of the *FCA* referred to in *MAR* 10.5.1G to *MAR* 10.5.3G can be applied to a *person* regardless of whether the *person* is situated or operating in the *UK* or abroad~~, where the relevant position relates to a *commodity derivative* or *emission allowance* for which the *FCA* is responsible for setting a position limit, or *economically equivalent OTC contracts*~~.

…

MAR 10 Annex 1 (Application form for a non-financial entity for an exemption from compliance with position limits) is deleted in its entirety. The deleted text is not shown but the annex is marked [deleted] as shown below.

10 Annex 1D **Application form for a non-financial entity for an exemption from compliance with position limits) [deleted]**

After MAR 10 Annex 1, insert the following new annex. The text is all new and is not underlined.

10 Annex 2R **List of critical contracts and related contracts subject to Position Limits**

Contract name
LME Aluminium
LME Copper
LME Lead
LME Nickel
LME Tin
LME Zinc
London Cocoa Futures
Robusta Coffee Futures
White Sugar Futures
UK Feed Wheat Futures

Low Sulphur Gasoil Futures
UK Natural Gas Futures
Brent Crude Futures
T-West Texas Intermediate

After MAR 10 Annex 2, insert the following new annex. The 3 tables previously located at Annex I of the following technical standard are to be moved to this annex: Commission Implementing Regulation (EU) 2017/1093 of 20 June 2017 laying down implementing technical standards with regard to the format of position reports by investment firms and market operators. Where amendments are to be made to the content of the tables, underlining indicates new text.

10 Annex 3R **Format for the weekly reports**

This annex consists of forms which can be found at the following link:

[*Editor's note*: insert link]

Table 1 Weekly Reports

Notation of the position quantity	Investment Firms or credit institutions		Investment Funds		Other Financial Institutions		Commercial Undertakings		Operators with compliance obligations under Directive 2003/87/EC <u>or the trading scheme order 2020</u>	
	Long	Short	Long	Short	Long	Short	Long	Short	Long	Short
…										

…

After MAR 10 Annex 3, insert the following new annex. The 2 tables previously located at Annex II of the following technical standard are to be moved to this annex: Commission Implementing Regulation (EU) 2017/1093 of 20 June 2017 laying down implementing technical standards with regard to the format of position reports by investment firms and market operators. Where amendments are to be made to the content of the tables, underlining indicates new text and striking through indicates deleted text.

10 Annex 4R **Format for the daily reports**

This annex consists of forms which can be found at the following link:

[*Editor's note*: insert link]

…

Table 2 Tables of fields to be reported for all positions across all maturities of all contracts for the purposes of ~~Article 2~~ MAR 10.4.1D

FIELD	DETAILS TO BE REPORTED	FORMAT FOR REPORTING
…		
Trading venue identifier	Field to be populated with the ISO 10383 segment MIC for positions reported in respect of on-venue contracts. Where the segment MIC does not exist, use the operating MIC. Use MIC code "XXXX" for off-venue positions in economically equivalent OTC contracts or related OTC contracts. Use MIC code "XOFF" for listed derivatives or emission allowances traded off-exchange.	{MIC}
Position type	Field to report whether the position is in either futures, options, emission allowances or derivatives thereof, commodity derivatives defined under ~~point (c) of Article 4(1)(44) of Directive 2014/65/EU of the European Parliament and of the Council or any other contract type~~ article 2(1)(24)(c) MiFIR.	
…		
Indicator of whether the position is risk reducing	Field to report whether the position is risk reducing in accordance with ~~Article 7 of Delegated Regulation (EU)~~	

in relation to commercial activity	~~2017/591~~ the hedging exemption in *MAR* 10.2.	
Indicator of whether the position is a pass-through of a hedging exemption	Field to report whether the position is a pass-through of a position that is risk-reducing in accordance with *MAR* 10.2	
Indicator of whether the position is entered into as part of an obligation to provide liquidity	Field to report whether the position is part of an obligation to provide liquidity in accordance with *MAR* 10.2.	

Amend the following as shown.

Sch 2 Notification requirements

…

Sch 2.2 G Notification requirements

Handbook Reference	**Matter to be notified**	**Contents of Notification**	**Trigger event**	**Time allowed**
…				
MAR 8.3.17R	…	…	…	…
MAR 10.2.1.IR	Position limit relating to *commodity derivative*	Position limit details relating to *spot month contracts* and *other months' contracts* separately	Occurrence	Without delay and prior to imposing a position limit unless it is not reasonably practicable to do so
MAR 10.2.11R	Position limit exemption granted to a *non-financial entity*	Details including any conditions such as an *exemption ceiling* attached to	Occurrence	Promptly; and on an annual basis a list of all exemptions granted to *non-financial entities*

Handbook Reference	Matter to be notified	Contents of Notification	Trigger event	Time allowed
		the exemption.		
MAR 10.2.18R	Position limit exemption to a *financial entity*	Details including any conditions such as an *exemption ceiling* attached to the exemption	Occurrence	Promptly; and on an annual basis a list of all exemptions granted to *financial entities*
MAR 10.2.23R	Position limit exemption granted to a liquidity provider	Details including any conditions such as an *exemption ceiling* attached to the exemption	Occurrence	Promptly; and on an annual basis a list of all exemptions granted to liquidity providers
MAR 10.3.3AR	*Accountability thresholds* review	Report details	Whenever there is a significant change to either the position limit or one or more of the factors in *MAR* 10.3.3BR; and at least on an annual basis	Promptly
MAR 10.3.4AR	Miscellaneous comprising: • risk assessment framework including policies and procedures related to *accountability threshold*	Details	Implementation and modification	Prior to implementation and modification allowing such time as is necessary for the *FCA* to consider and assess the relevant matters,

Handbook Reference	Matter to be notified	Contents of Notification	Trigger event	Time allowed
	breaches, market risk analysis and *additional reporting* arrangements; • *additional reporting* and other reporting arising from market risk analysis; • *accountability thresholds*; • governance arrangements including for setting position limits and accountability thresholds, identification of relevant contracts and netting arrangements; • methodologies; • list of *related contracts*, *related OTC contracts* and *related overseas commodity derivative contracts*; • policies and procedures relating to position limit exemptions and breaches; and • information sharing with *CCPs*.			prior to proposed implementation

Annex C

Amendments to the Decision Procedure and Penalties manual (DEPP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

2 Statutory notices and the allocation of decision making

…

2 Annex 2 Supervisory notices

…

Markets in Financial Instruments Regulations 2017	Description	Handbook reference	Decision maker
…			
Regulation 28(4)	when the *FCA* is imposing a limitation, restriction or requirement under regulation ~~24~~ 28(4)		*Executive procedures* (see *DEPP* 2.5.18G)
…			

Annex D

Amendments to the Recognised Investment Exchanges sourcebook (REC)

In this Annex, striking through indicates deleted text.

2 Recognition requirements

2.1 Introduction

…

2.1.4 G Location of recognition requirements and guidance

Recognition Requirements Regulations	Subject	Section in REC 2/other parts of the *Handbook*
…		
Paragraphs 7BA & 7BB	Position ~~management and position~~ reporting re commodity derivatives	2.7A
…		

…

2.7A Position ~~management and position~~ reporting in relation to commodity derivatives

…

2.7A.1 UK

~~Paragraph 7BA – Position management~~		
~~(1)~~	~~A [*UK RIE*] operating a trading venue which trades commodity derivatives must apply position management controls on that venue, which must at least enable the [*UK RIE*] to~~ - [deleted]	
	~~(a)~~	~~monitor the open interest positions of persons;~~

	~~(b)~~	~~access information, including all relevant documentation, from persons about~~	
		~~(i)~~	~~the size and purpose of a position or exposure entered into;~~
		~~(ii)~~	~~any beneficial or underlying owners;~~
		~~(iii)~~	~~any concert arrangements; and~~
		~~(iv)~~	~~any related assets or liabilities in the underlying market;~~
	~~(c)~~	~~require a person to terminate or reduce a position on a temporary or permanent basis as the specific case may require and to unilaterally take appropriate action to ensure the termination or reduction if the person does not comply; and~~	
	~~(d)~~	~~where appropriate, require a person to provide liquidity back into the market at an agreed price and volume on a temporary basis with the express intent of mitigating the effects of a large or dominant position.~~	
~~(2)~~	~~The position management controls must take account of the nature and composition of market participants and of the use they make of the contracts submitted to trading and must~~ [deleted]		
	~~(a)~~	~~be transparent;~~	
	~~(b)~~	~~be non-discriminatory; and~~	
	~~(c)~~	~~specify how they apply to persons.~~	
~~(3)~~	~~A [*UK RIE*] must inform the FCA of the details of the position management controls in relation to each trading venue it operates.~~ [deleted]		
…			

…

Annex E

Amendments to the Enforcement Guide (EG)

In this Annex, striking through indicates deleted text.

19 Non-FSMA powers

…

19.34 Markets in Financial Instruments Regulations 2017

19.34.1 G The *MiFI Regulations* in part implemented *MiFID*. The *FCA* has investigative and enforcement powers in relation to both criminal and non-criminal breaches of the *MiFI Regulations* (including requirements imposed on persons subject to the *MiFI Regulations* by *MiFIR* and any *onshored regulation* which was an *EU regulation* made under *MiFIR* or *MiFID*). The *MiFI Regulations* impose requirements on:

(1) *persons* holding positions in relevant contracts for commodity derivatives trading on *trading venues* ~~and for *economically equivalent OTC contracts*~~, whether or not the *persons* are authorised; and

…

…

…

Annex F

Amendments to the Perimeter Guidance manual (PERG)

In this Annex, underlining indicates new text and striking through indicates deleted text.

2 Authorisation and regulated activities

…

2.9 Regulated activities: exclusions applicable in certain circumstances

…

~~Persons seeking to use the exemption under Article 2.1(j) of the Markets in Financial Instruments Directive~~

2.9.30 G ~~This exclusion applies to the activities of:~~

~~(1) *dealing in investments as principal*;~~

~~(2) *dealing in investments as agent*; and~~

~~(3) *arranging (bringing about) deals in investments*.~~

~~It is available to a *person* who is not an *authorised person* and whose activity is one to which article 2(1)(j) of *MiFID* applies (see *PERG* 13 Q44). Where the *person* meets the conditions of the exemption relating to article 2(1)(j) but during a calendar year is not able to perform the market threshold test in article 2 of *MiFID RTS 20* because the relevant data is not available from an *EU* institution or regulator, its activities are excluded from the activities in (1) to (3) above. Similarly, if the *person* has made an application for a *Part 4A permission* in relation to any of the activities in (1) to (3) above, to which article 2(1)(j) of *MiFID* applies, the exclusion applies for as long as that application has not been determined or withdrawn. In each case, a *person* seeking to rely on the article 2(1)(j) exemption must provide notice to the *FCA* in accordance with regulation 47 of the *MiFI Regulations*.~~ [deleted]

…

13 Guidance on the scope of the UK provisions which implemented MiFID

…

13.5 Exemptions from MiFID

…

Exemption for commodity derivatives business

…

Q44A. How do I know whether my main business is investment, banking or commodities?

When considering what is a group's 'main business' for the purpose of the requirement described in the answer to Q44 that your main business should not be investment services, banking services or commodity derivatives market making, in our view various factors are likely to be relevant including turnover, profit, capital employed, numbers of employees and time spent by employees. These factors should then be considered in the round in deciding whether any one operation or business line amounts to your group's main business.

The determination of your main business as described in this answer is not directly related to the test for deciding whether your commodities business is ancillary to your main business (the ancillary test is referred to in the answer to Q45). This is because the ancillary test compares the size of your ~~commodities~~ commodity derivatives and emission allowance business (see guidance in PERG 13Q32 to 33C and 34A above) with the rest of your business but does not specify how to identify what your main business is within your non-commodities business.

Q44B. Are there any formalities for using the commodities exemption?

It is a condition of the commodities exemption described in the answer to Q44 that you~~:~~

- ~~should notify annually the relevant competent authority that you make use of this exemption; and~~
- upon request, report to the competent authority the basis on which you consider that the requirement for the commodities business to be ancillary is met.

~~If you are a UK firm, the~~ The FCA is the relevant competent authority for these purposes.

If you carry out some occasional commodity derivatives activities you may not need to rely on this exemption. See the answer to Q7 (We provide investment services to our clients. How do we know whether we are an investment firm for the purposes of article 4.1(1) MiFID?) for more on this.

…

Q45. What is an ancillary activity for the purposes of the commodities exemption and who can rely on it?

~~You can find the meaning of 'ancillary' for the purposes of the commodities exemption described in the answer to Q44 in MiFID RTS 20 (regulatory technical standards for the criteria to establish when an activity is considered to be ancillary to the main business). You will need to consider whether your commodity derivatives business exceeds the main business threshold as stipulated in article 3 of MiFID RTS 20.~~

~~This answer does not give a full summary as the definition is too detailed for *PERG*.~~

~~The test as stipulated by article 3 of MiFID RTS 20 has two calculation methods. If the result of either calculation is that you fall below the specified threshold, you meet the test.~~

- ~~One method is based on the size of group trading activities in commodity derivatives and emission allowances.~~
- ~~The second measure compares the estimated capital employed for carrying out commodity derivative and emission allowance activities with group capital.~~

~~Both methods are based on commodities trading activities in the EEA, as if the UK were still part of the EU.~~

The commodities exemption can be relied on by a wide range of firms whose groups are engaged in buying or selling commodity derivatives or emission allowances as a result of their group's main business. For example, where you are a commodity producer who buys or sells commodity derivatives or emission allowances for the purposes of limiting an identifiable risk of its main business for risk management purposes, this would qualify as ancillary for the purposes of this exemption. This is the case for many types of businesses relying on the exemption and whose main activity relates to the commodities described in *PERG* 13 Q33 above.

More generally, the meaning of 'ancillary' for the purposes of the commodities exemption envisages the business being related and subordinate to the main business of the group. Where a firm's activity goes beyond the use of commodity derivatives and emission allowances business for purely risk management purposes, in our view other factors are relevant to determining whether a person's business is ancillary to the main business of their group. Consistent with well-established principles as previously set out in *MiFID RTS 20*, we consider that firms may continue to choose to rely on either:

- their trading activity against the overall trading activity of the group (the trading test); or
- the estimated capital their group would be required to hold against the market risk inherent in their trading in commodity derivatives, emission allowances and emission allowance derivatives (the capital employed test),

when satisfying themselves that they are carrying on ancillary activity for the purposes of the commodities exemption.

For these purposes, firms may have regard to the trading tests and capital employed tests in Commission Delegated Regulation (EU) 2021/1833 (references to the 'Union' being treated as references to the 'UK', 'trading venues' as references to UK and EU trading venues and authorised investment firms and credit institutions as references to corresponding UK and EU authorised entities).

In addition, when considering whether your investment services or activities are ancillary to your main business, when considered on a group basis, you may also have regard to the profits, staff numbers and their time spent in relation to these investment services or activities.

The commodities exemption is relevant to you if you carry on MiFID business and rely on an *RAO* exclusion such as article 16 (Dealing in contractually based investments) or article 19 (risk management) (see *PERG* 2.8.4G) when carrying on investment services and activities in the UK. These exclusions are unavailable to firms when they are carrying on MiFID business, hence the relevance of this exemption.

…

TECHNICAL STANDARDS (COMMODITY DERIVATIVES) (POSITION LIMITS, MANAGEMENT, REPORTING AND PERIMETER) INSTRUMENT 2024

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the powers and related provisions in or under:

(1) article 26(9) (Obligation to report transactions) of, and paragraphs 19, 31, 32 and 33 of Schedule 3 to, 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; and

(2) the following sections of the Financial Services and Markets Act 2000 ("the Act"):

(a) section 138P (Technical standards);
(b) section 138Q (Standards instruments);
(c) section 138S (Application of Chapters 1 and 2); and
(d) section 137T (General supplementary powers).

B. The provisions listed above are specified for the purposes of section 138Q(2) (Standards instruments) of the Act.

Pre-conditions to making

C. The FCA has consulted the Prudential Regulation Authority and the Bank of England as appropriate in accordance with section 138P of the Act.

D. A draft of this instrument has been approved by the Treasury in accordance with section 138R of the Act.

Interpretation

E. In this instrument, any reference to any provision of direct EU legislation is a reference to it as it forms part of retained EU law.

Modifications

F. The FCA revokes the following technical standards:

(1) Commission Delegated Regulation (EU) No 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;

(2) Commission Delegated Regulation (EU) 2017/592 of December 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the criteria to establish when an activity is considered to be ancillary to the main business;

(3) Commission Implementing Regulation (EU) No 2017/953 of 6 June 2017 laying down implementing technical standards with regard to the format and the timing of position reports by investment firms and market operators of trading venues; and

(4) Commission Implementing Regulation (EU) No 2017/1093 of 20 June laying down implementing technical standards with regard to the format of position reports by investment firms and market operators.

G. The FCA amends the following technical standard in accordance with the Annex to this instrument:

Commission Delegated Regulation (EU) 2017/590 of 28 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the reporting of transactions to competent authorities.

Commencement

H. This instrument comes into force on [*date*].

Citation

I. This instrument may be cited as the Technical Standards (Commodity Derivatives) (Position Limits, Management, Reporting and Perimeter) Instrument 2024.

By order of the Board
[*date*]

In this Annex, underlining indicates new text and striking through indicates deleted text.

Annex

Commission Delegated Regulation (EU) 2017/590 of 28 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the reporting of transactions to competent authorities

…

ANNEX I

…

Table 2 **Details to be reported in transaction reports**

N	FIELD	CONTENT TO BE REPORTED	FORMAT AND STANDARDS TO BE USED FOR REPORTING
…			
Trader, algorithms, waivers and indicators			
…			
64	Commodity derivative indicator	Indication as to whether the transaction reduces risk in an objectively measurable way in accordance with ~~regulation 17 of the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017~~ <u>the non-financial entity exemption in *MAR* 10.2</u>. Where the transaction is for a transmitted order that has met the conditions for transmission set out in Article 4, this field shall be populated by the receiving firm in the receiving firm's reports using the information received from the transmitting firm. This field is only applicable for commodity derivative transactions.	"true" - yes "false" - no
…			

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