

OPINION on position limits on EEX Spanish Power Base contracts

I. Introduction and legal basis

1. On 20 October 2017, the European Securities and Markets Authority (“ESMA”) received a notification from the Federal Financial Supervisory Authority (“BaFin”) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments¹ (“MiFID II”) regarding the exact position limits the BaFin intends to set for the EEX Spanish Power Futures and Options commodity contracts in accordance with the methodology for calculation established in Commission Delegated Regulation (EU) 2017/591 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 in commodity derivatives² (“RTS 21”) and taking into account the factors referred to in Article 57(3) of MiFID II.
2. ESMA’s competence to deliver an opinion is based on Article 57(5) of MiFID II. In accordance with Article 44(1) of Regulation (EU) 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority)³ (“ESMA Regulation”), the Board of Supervisors has adopted this opinion.

II. Contract classification

Commodity base product: energy (NRGY)

Commodity sub product: electricity (ELEC)

Commodity further sub product: baseload (BSLD)

Name of trading venue: EUROPEAN ENERGY EXCHANGE

MIC: XEEE

Venue product codes: FEB, OEB

¹ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349).

² Commission Delegated Regulation (EU) 2017/591 of 1.12.2016 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 commodity derivatives (OJ L 87, 31.3.2017, p. 479).

³ Regulation (EU) 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15. 12.2010, p84).

III. Market description by the competent authority

3. The Spanish Power Base Futures and Options contract is a cash-settled derivatives contract that refers to the average power spot market price of future delivery periods of the Spanish market area. For options, the corresponding futures position of the underlying asset is booked upon exercising of the option. The Portuguese market area is not covered. The contracts are traded in lots for which one lot equals 1MW. For futures, days, week-ends, weeks, months, quarters and years are listed in parallel. For options, months, quarters and years are listed in parallel.
4. Electricity is a grid-bound commodity, where delivery takes place through meshed transmission system grids. This means that market participants have no control over the actual destination of the generated power. Electricity can only be stored to a very minimal extent, i.e. by means of battery storage. In fact, electricity is still widely considered as a non-storable commodity. There are also some seasonal effects in the electricity market. Due to heating demand in winter and air-conditioning demand in summer, electricity generation tends to be higher in those seasons. However, such seasonal effects are small.
5. Compared to other market areas in the EU, the Spanish electricity market is relatively isolated from the grids of its neighbouring countries due to its low cross-border capacity. Its interconnection capacity remains at around 3% of installed capacity. However, additional interconnections with France are being planned. In electricity, Spain and Portugal form a single spot market (MIBEL) with two bidding zones.
6. Spain has built a well-diversified power generation fleet and a very reliable power system. In accordance with EU targets for 2020 on Greenhouse gases (GHG) reduction, the role of renewable energy sources becomes more and more important. In 2015 hydroelectric power generation made up 14.5% and wind power 23.7% of total generation.
7. Power generation is mainly in the hands of several major entities, such as Endesa and Iberdrola. Sole operator of the national power transmission system is Red Eléctrica de España (REE) that is a partly state-owned and a public limited Spanish corporation. However, Spain underwent an electricity market reform in recent years that strengthened the role of the national regulatory authority (National Commission of Markets and Competition - CNMC). It is now entitled to approve the methodologies to calculate transmission and distribution of tariffs, the provision of balancing services and access to cross-border infrastructures.

IV. Proposed limit and rationale by the competent authority

Spot month position limit

Deliverable supply

8. Deliverable supply amounts to 80,089,930 MWh.

9. The deliverable supply was estimated based on statistics provided by ENTSO-e⁴. It is composed of the domestic Net Generating Capacity (NGC) of Spain as displayed on the ENTSO-e website and its average yearly import capacities from its neighbouring countries for 2017.
10. The Net Generating Capacity (in MW) in 2017 for Spain was 105,429 MW⁵. The quantity of the power that can be used to fulfil delivery requirements of the Spanish power contracts should also take into account the import capacity that Spain can obtain from both France and Portugal⁶, which amounts up to 4,289 MW, coming up to a total Deliverable Supply of 109,718 MW
11. These values of ENTSO-E have been converted from MW to MWh per year. The overall value was then divided by 12 in order to align the deliverable supply to the time frame of one calendar month, i.e. the spot month period.

Spot month position limit

12. The spot month limit is 12,814,389 MWh, which represents 16% of deliverable supply. The spot month limit applies to Spanish Power Futures and Options contracts. The spot month includes daily, weekend, weekly and monthly contracts.

Spot month position limit rationale

13. Since the Spanish Power Futures and Options contract is not a food contract, its baseline figure for the spot month, which is based on deliverable supply, was calculated as 25% of the estimated deliverable supply ($0.25 \times 80,089,930 \text{ MWh} = 20,022,483 \text{ MWh}$).
14. As there are less than three market makers, the limit is to be set within a range of 5% - 50% of deliverable supply.
15. The following factors were considered relevant for adjusting the limit downwards:
 - Article 18(3) of RTS 21: The deliverable supply is significantly higher than the open interest. Based on the rationale of Article 18(3) of RTS 21 it is therefore legitimate to adjust the spot month limit downward. However, it needs to be taken into account that the disparity between deliverable supply and open interest is not as significant as in other contracts.
 - Article 20(2)(d): Import capacities are very limited, thus restrictions on the supply of the commodity exist.

⁴ European Network of Transmission System Operators for Electricity.

⁵ <https://transparency.entsoe.eu/generation/r2/installedGenerationCapacityAggregation/show>

⁶ <https://transparency.entsoe.eu/transmission-domain/ntcYear/show>

16. In considering the volatility in the contract, as required by Article 21 of RTS 21, there has been some variation in the price of the commodity derivative but BaFin has not found evidence that this is excessive or that lower position limits would reduce volatility.
17. All the other potential adjustment factors set out in RTS 21 have been considered and were not regarded as material or relevant to require additional adjustments, either up or down, from the baseline.
18. Based on the above, BaFin has decided to set a total downward adjustment of 9-percentage points resulting in an adjusted baseline of 16% of deliverable supply. This provides a figure of 12,814,389 MWh.

Other months' position limit

Open interest

19. The open interest amounts to 56,768,000 MWh. The open interest value was provided by the exchange. It was calculated by aggregating all contracts across all maturities and converting them to MWh. The number provided is the average size of daily open interest throughout three consecutive months (June, July and August 2017). Option positions have been delta adjusted.

Other months' position limit

20. The other months limit amounts to 14,192,000 MWh, which represents 25% of open interest. The other months' limit applies to Spanish Power Futures and Options contracts. It includes monthly (other than spot month), quarterly and yearly contracts.

Other months' position limit rationale

21. The baseline figure for the other months limit amounts to 25% of open interest.
22. The following factors were considered relevant for adjusting the baseline upwards:
 - Article 18(3) of RTS 21: The overall open interest is significantly lower than deliverable supply. However, the disparity is not significant enough to justify a major increase of the position limit.
23. The following factors were considered relevant for adjusting the limit downwards:
 - Article 20(2)(d): Import capacities are very limited, thus restrictions on the supply of the commodity exist.
24. In considering the volatility in the contract, as required by Article 21 of RTS 21, there has been some variation in the price of the commodity derivative but BaFin has not found evidence that this is excessive or that lower position limits would reduce volatility.

25. All the other potential adjustment factors set out in RTS 21 have been considered and are not regarded as material or relevant to require additional adjustments, either up or down, from the baseline.
26. BaFin is of the view that overall applying 25% as limit seems adequate as the potential upward and downward adjustments offset each other. The disparity between deliverable supply and open interest is not significant enough to justify a further increase of the position limit.

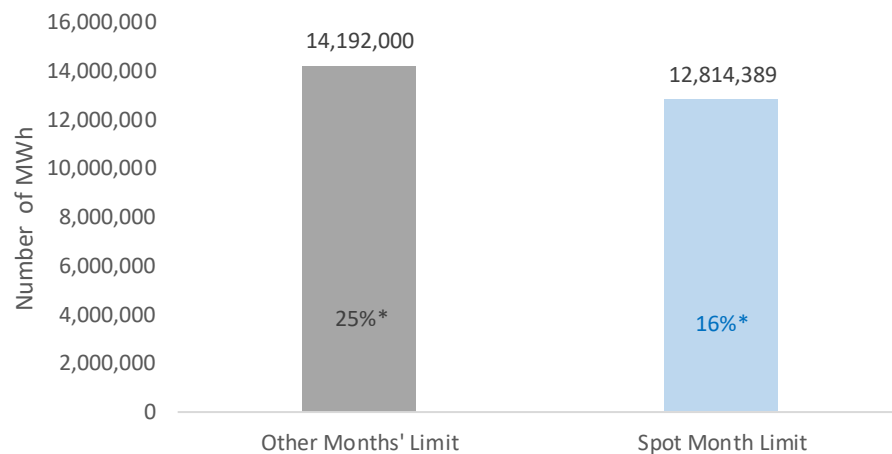
V. ESMA's Assessment

27. This Opinion concerns positions held in Spanish Power Futures and Options contracts.
28. ESMA has performed the assessment based on the information provided by BaFin.
29. For the purposes of this Opinion, ESMA has assessed the compatibility of the intended position limits with the objectives of Article 57(1) of MiFID II and with the methodology for calculation of position limits established in RTS 21, in accordance with Article 57(3) of MiFID II.
30. When performing this assessment, ESMA also took into account the need to ensure that the methodology set out in RTS 21 promotes a consistent application of position limits across competent authorities including when commodity derivatives are based on the same underlying such as Spanish power in this case.

Compatibility with the methodology for calculation of position limits established in RTS 21 in accordance with Article 57(3) of MiFID II

31. BaFin has set one position limit for the spot month and one position limit for the other months.

Position limits applying during the lifetime of an EEX Spanish Power Base Contract



*Position limit as % of Open Interest

*Position limit as % of Deliverable Supply

Spot month position limit

32. The calculation of the deliverable supply is based on ENTSO-e figures for 2017 and includes both domestic generation plus imports into Spain (from France and Portugal). The source of data used to calculate deliverable supply (ENTSO-e statistics) ensures publicly available figures that are consistent at the European level.
33. ESMA considers that the methodology used to calculate deliverable supply is consistent with Article 10(1) of RTS 21 that sets out that deliverable supply shall be calculated “by identifying the quantity of the underlying commodity that can be used to fulfil the delivery requirements of the commodity derivative.”
34. The monthly deliverable supply figure has been calculated by converting the capacity (expressed in MW) to MWh per month.
35. This approach is consistent with Article 10(2) of RTS 21, which sets out that “Competent authorities shall determine the deliverable supply [...] by reference to the average monthly amount of the underlying commodity available for delivery over the one-year period immediately preceding the determination”.
36. ESMA agrees that the rationale underpinning Article 18(3) of RTS 21 with respect to the spot month enables the national competent authority to adjust the spot month limit downwards in case the deliverable supply is significantly higher than the open interest. ESMA therefore considers that a downward adjustment of the spot month limit for the Spanish power Future contracts is reasonable under Article 18(3) of RTS 21.



37. Because of the very limited import capacity of the Spanish power market, ESMA considers reasonable to adjust the spot limit downwards under Article 20(2)(d) of RTS 21.

Other months' position limit

38. The open interest was calculated as the daily average of three months in 2017 of the number of open contracts that have not been closed out or expired. ESMA considers such an approach sensible in this case as an average for a period of time gives a more stable measure of open interest and considers such approach consistent with Article 12 of RTS 21.

39. ESMA agrees that the different downward and upward adjustments considered by BaFin balance each other out resulting in an other months' position limit of 25% of Open Interest.

40. Consequently, these position limits have been set following the methodology established by RTS 21.

41. ESMA also notes that, overall, the position limits set result in a consistent and harmonised approach in the application of position limits for derivatives contracts based on Spanish power.⁷

Compatibility with the objectives of Article 57(1) of MiFID II

42. Under Article 57(1) of MiFID II, the objectives of the position limits are to prevent market abuse and support orderly pricing and settlement conditions including preventing market distorting positions.

43. With respect to the spot month limit, ESMA notes, based on the information provided by the competent authority, that the limit is substantially higher than open interest in the spot month throughout 2017.

44. ESMA understands the need to avoid the risk of unduly constraining trading in this commodity derivative market where underlying market participants have a key presence. However, there is a risk that the objectives set out in Article 57(1) of MiFID II may not be achieved where the limit set for the spot month is well above the positions held by market participants in the spot month

45. In light of the assessment above, ESMA considers that the position limit set for the spot month and the other months, overall appear to achieve a reasonable balance between the need to prevent market abuse and to ensure an orderly market and orderly settlement while ensuring that the development of commercial activities in the underlying commodity market and the liquidity of the EEX Spanish Power Base contracts are not hampered

⁷ Add link to the Opinion on the MEFF Spanish Power Base contract



46. However, to help ensure that the risk of not achieving the objectives set out in Article 57(1) of MiFID II does not materialise, ESMA considers that trading patterns in the EEX Spanish Power Base contracts should be carefully monitored by the competent authority, in particular during the spot month, and that the spot month limit should be reviewed on a timely basis.

VI. Conclusion

47. Based on all the considerations and analysis presented above, it is ESMA's opinion that the spot month position limit does comply with the methodology established in RTS 21 and is consistent with the objectives of Article 57 of MiFID II. The other months' position limit does also comply with the methodology established in RTS 21 and is consistent with the objectives of Article 57 of MiFID II.

Done at Paris,

Steven Maijor

Chair

For the Board of Supervisors