European Securities and Markets Authority

Date: 29 January 2020
ESMA70-155-8802

OPINION on position limits on MEFFPOWER Baseload Futures contracts

I. Introduction and legal basis

1. On 1 March 2019, the European Securities and Markets Authority (ESMA) received a notification from Comisión Nacional de los Mercados de Valores (CNMV) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments[1] ("MiFID II") regarding the exact position limits the CNMV intends to set for the MEFFPOWER Baseload Futures commodity contract 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 derivatives[2] ("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: base load (BSLD)

Name of trading venue: MEFF - SEGMENTO DERIVADOS ENERGIA,

MIC: XMPW

Venue product code: DEEB

[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, p. 84).

III. Market description

3. The MEFFPOWER Baseload Futures contract is a cash-settled derivative contract settling against the reference daily price of the spot market for the taking and delivery of electricity in Spain. The contracts are traded in lots for which one lot equals 1MW or 0.1MW. Days, weeks, months, quarters and years are listed in parallel.

4. Every day the reference price is calculated for the next day as the arithmetic average of the 24-hourly prices obtained for the Spanish bidding zone of the project PCR (Price Coupling of Regions), an auction for which a complex algorithm provides the programming of taking and delivery of electricity in several European bidding zones.

5. In electricity, Spain and Portugal form a single spot market (MIBEL) with two bidding zones. The market splits in two different prices (one for Spain and the other for Portugal) when the implicit flow of power from the results of the algorithm PCR is not compatible with the available capacity of the Spain-Portugal power interconnection. This market splitting happens in a low percentage of hours because the coupling rate between Spain-Portugal bidding zones has been consistently over 90% from 2011 (even higher, 94% in 2014 or 98% in 2015), that is, more than 90% of all the hours, the price in the spot power market is identical in Spain and Portugal.

6. Another way to measure the coupling is that the annual average difference of spot prices between Spanish and Portuguese power markets has been below 1€/MWh every year since 2009. This fact is very relevant also for the derivatives market, since SPEL contracts with cash settlement against the Spanish power spot price are the benchmark used to cover market risks in MIBEL, for those exposed to either Spanish or Portuguese spot prices, because derivatives over Spanish prices are much more liquid than those over Portuguese prices.

7. On the other hand, the power interconnection capacity between Spain and France has been historically very limited and currently is below 3% of Spanish generation capacity and below 2% if MIBEL is considered as a whole, since the Iberian Peninsula does not have other power interconnections than those with France. For this reason, the coupling rate between Spain and France is low (24,7%) and Iberian power system is basically considered isolated from the rest of Europe.

8. Other important characteristic is the high proportion of renewable generation capacity and production higher for the whole MIBEL since renewable market share is even larger in Portugal than in Spain.

9. In Spain, retail demand is seasonal, being higher in extreme weather conditions in summer and winter, and lower in autumns and specially in springs.

10. Electricity is a grid-bound commodity, where delivery takes place through meshed transmission system grids and power producers have no control over the actual destination of the generated electricity.

11. The electricity system is critical, not only for the economy but also for reasons related to national security. For this reason, it is subject to close surveillance of national and European regulators, including supervision for the purpose of the prevention of abusive practices of dominant positions. Similar to financial markets, REMIT prohibits market manipulation of the spot market.

12. Power is a basic product for the standard of leaving whose demand generally shows a very low elasticity to price. For this reason, the ability to manage the demand is small, in terms of global quantity and in relation of the time in the day to be satisfied, as there is a daily pattern that just reflects human activity. Only large industrial consumers adapt their power consumption to the hours when electricity demand and prices are lower.

13. Then, it is supply that has to be very flexible to meet this demand. Indeed, supply cannot take much advantage of stored power, as the storage is expensive and limited to a small proportion of the generation capacity, mainly from facilities with pumping technology. There is also a technical need for a continuous balance between supply and demand because if supply does not match exactly the demand with a level of quality and continuity, imbalances are expensive and potentially risky for the whole system, the generation facilities, the consumer devices and the future security of the supply.

14. As a result, all these features together (inflexible demand, need of continuous balance supply-demand, lack of ability to store power, isolated system, and high proportion of renewables –whose fuel, sun or wind, is neither storable nor manageable as gas and coal are-), makes MIBEL power a very special commodity. It is only a large surplus on the supply side that may avoid an extreme inherent volatility in the spot power market, as typically hourly changes in demand lead to hourly movements in prices4.

15. The number of participants in 2015 (last figures publicly available) in the Spanish zone of MIBEL spot market were the following:

- From the supply side, 85 companies offer daily bids (for every of the 24 hours of the next day) of its generation (producing) facilities (roughly 80.000 in Spain). The supply of the biggest producing company in the daily auction stands for the 21% of the MIBEL Spain spot market size (H1=21). There are three main big players (H3=58) and the six biggest players stands for the 77%. There are 11 companies whose stake in the production side of MIBEL Spain spot is over 1% and H11= 87. The Herfindahl-Hirschman index (HHI) to measure the concentration of the supply in MIBEL Spain is around 1.300, meaning that it is not a concentrated market.

[4] This pattern in hourly volatile prices explains why a peakload contract exists as a different contract than the baseload one.

- From the demand side, around 280 companies offer daily bids to cover their customers' demand (some of them being intensive power customers themselves). The concentration figures are the following: H1= 27, H3=59. 10 groups stand for the 90% of the whole MIBEL Spain spot market.

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

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

17. The deliverable supply was estimated based on statistics provided by ENTSO-e5. 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 of its neighbouring countries for 2017.

18. The Net Generating Capacity (in MW) in 2017 for Spain was 105,429 MW6. 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 Portugal7, which amounts up to 4,289 MW, coming up to a total Deliverable Supply of 109,718 MW.

19. These values of ENTSO-E have been converted from MW to MWh per year. The overall value was then divided by the factor of 12 in order to align the deliverable supply to the time frame of one calendar month for the spot month period.

Spot month position limit

20. The spot month limit is 10,000,000 MWh, which represents 12,5% of deliverable supply. The spot month limit is defined by 30 calendar days. The spot month includes daily, weekly and monthly contracts.

Spot month position limit rationale

21. Since the 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.

22. As there is no market maker for this contract, according to Article 19(2)(b) of RTS 21, the position limit for this contract has to be set between 5% and 50% of deliverable supply.

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[5] European Network of Transmission System Operators for Electricity.
[6] https://transparency.entsoe.eu/generation/r2/installedGenerationCapacityAggregation/show
[7] https://transparency.entsoe.eu/transmission-domain/ntcYear/show

23. The following factor was 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 rational of Article 18(3) of RTS 21 it is therefore legitimate to adjust the spot month limit downward.

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 CNMV 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 were not regarded as material or relevant to require additional adjustments, either up or down, from the baseline.

26. Based on the above, CNMV has decided to set a total downward adjustment of 12.5 percentage points resulting in an adjusted baseline of 12.5% of deliverable supply. This provides a rounded figure of 10,000,000 MWh.

Other months' position limit

Open interest

27. The open interest amounts to 6,814,321 MWh. The open interest has been calculated on a gross basis for all the members of the trading venue. The open interest for every holder is the aggregation (in units of underlying MWh) of all the outstanding derivatives positions on Spanish baseload contracts of power registered as traded in MEFFPOWER.

28. Open interest was calculated as the daily average of total open interest in MEFFPOWER baseload futures contracts in the period 1-october-2017 to 30-september-2018. The figure for every day included in the calculation aggregates the position in all the contracts previously referred (i.e. not only those that are still opened to trade, but also those whose registration is no longer possible but whose delivery period has not finished the day of the daily calculation).

Other months' position limit

29. The other months limit amounts to 3,400,000 MWh, which represents 50% of open interest. It includes monthly (other than spot month), quarterly and yearly contracts.

Other months' position limit rationale

30. As there is no market maker for this contract, according to Article 19(2)(b) of RTS 21, the position limit for this contract has to be set between 5% and 50% of open interest.

31. The following factors were considered relevant for adjusting the limit upwards:

- Article 16 of RTS 21: There is large number of separate expiries open for registration, which number fluctuates from a minimum of 60 to a maximum of 90.

- Article 18(3) of RTS 21: The overall open interest is significantly lower than deliverable supply.

- Article 20(2)(d) and (e): Due to competition that affects the structure, the organisation and the operation of the market, the electricity market is Spain is less prone to market manipulation.

32. 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 CNMV has not found evidence that this is excessive or that lower position limits would reduce volatility.

33. 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.

34. Based on the above, CNMV has decided to set a total upward adjustment of 25-percentage points resulting in an adjusted baseline of 50% of open interest. This provides a figure of 3,400,000 MWh.

V. ESMA's Assessment

35. This Opinion concerns positions held in MEFFPOWER Baseload Futures contracts.

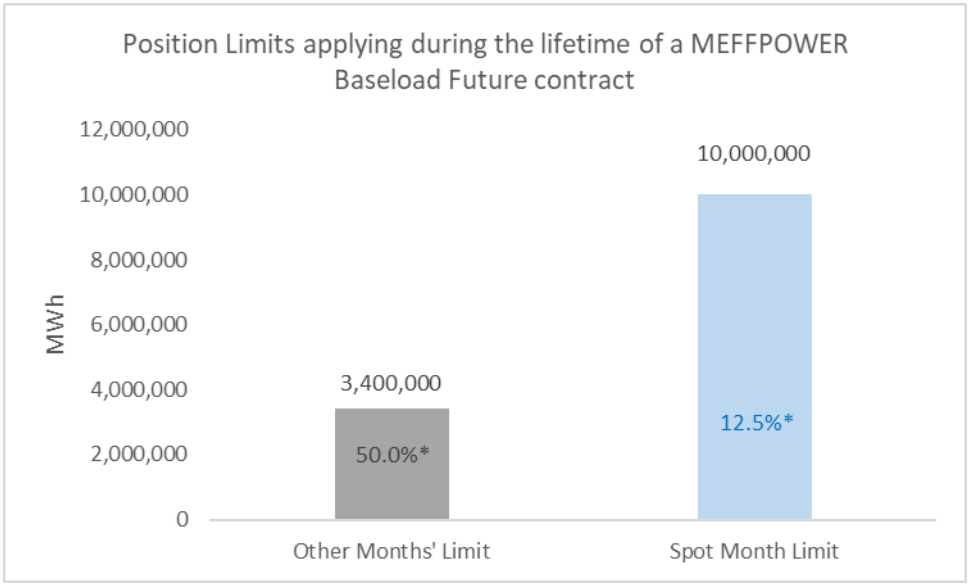
36. ESMA has performed the assessment based on the information provided by CNVM.

37. 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.

38. 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

39. In accordance with Article 57(3) of MiFID II, CNMV has set one position limit for the spot month and one position limit for the other months.



*Position limit as % of Deliverable Supply

Spot month position limit

40. The deliverable supply was estimated based on ENTSO-E (European Network of Transmission System Operators for Electricity) data. It is composed of the average Spanish domestic Net Generating Capacity (NGC) and Spain yearly power import capacity for the year 2017. ESMA agrees with using data from ENTSO-E data to calculate deliverable supply as this ensures publicly available figures consistent at the European level.

41. 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."

42. The monthly deliverable supply figure has been calculated by converting the capacity (expressed in MW) to MWh per month.

43. 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".

44. ESMA agrees that the rationale underpinning Article 18(3) with respect to the other months' 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 MEFFPOWER Baseload

Futures contracts is reasonable under Article 18(3) given the very large difference between deliverable supply and open interest.

Other months' position limit

45. The open interest was calculated as the daily average of total open interest in MEFFPOWER baseload futures contracts in the period 1-october-2017 to 30-september-2018. 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.

46. ESMA considers that the adjustment made under Article 16 of RTS 21 is appropriate given the large number of separate expiries.

47. The other months' limit has been adjusted upwards to take into consideration the fact that the amount of open interest is significantly lower than the deliverable supply. This is consistent with Article 18(3) of RTS 21.

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

49. 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.[8]

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

50. 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.

51. 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 2018.

52. ESMA understands the need to avoid the risk of unduly constraining trading in this commodity derivative market where participants in the underlying market 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.

53. 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

[8] Add link to the Opinion on EEX Spanish Power Base Contract

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 MEFFPOWER Baseload Futures contract are not hampered.

54. 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 MEFFPOWER Baseload Futures contract 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

55. 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 Maijoor

Chair

For the Board of Supervisors