Date: 31 July 2020
ESMA-70-155-10053

OPINION on position limits on EEX PEG natural gas contracts

I. Introduction and legal basis

1. On 3rd April 2020, the European Securities and Markets Authority (ESMA) received a notification from Federal Financial Supervisory Authority (BaFin) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments[1] ("MiFID II") regarding the exact position limits BaFin has set for Point d'Échange de Gaz (PEG) natural gas futures 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 derivatives[2] ("RTS 21") and taking into account the factors referred to in Article 57(3) of MiFID II. The contract used to be traded on Powernext until 1st of January 2020 when the trading has been moved to EEX following the merger between two entities.

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: natural gas (NGAS)

Commodity further sub product: other (OTHR)

Name of trading venue: European Energy Exchange (EEX)

MIC: XEEE

Venue product code: G5B

[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 by the competent authority

3. Natural gas is a hydrocarbon gas mixture consisting largely of methane and other hydrocarbons, occurring naturally underground (often in association with petroleum). It is used as a source of energy for heating, cooking, electricity generation, fuel for vehicles and chemical feedstock in the manufacture of plastics and other organic chemicals.

4. The French gas market is the fourth largest in Europe and dependent on imports, mainly from Norway, the Netherlands, Russia and Algeria. About 72% of the entry capacity to the French gas network is from cross-border gas pipelines, and the remaining entry capacity (about 28%) is from gas from France's four existing LNG import terminals. The French gas market is organized, since November 2018, in one single market zone (Trading Region France or TRF) and one single virtual trading point (PEG). This zone results from the merger of the previous PEG Nord and TRS.

5. The PEG contract is a derivatives contract referring to the future physical delivery of gas into the French market area (Trading Region France - TRF) through the Virtual Trading Point PEG which is controlled by GDF Suez via its subsidiary GRTgaz. While the liquidity in the spot markets is well developed, the derivative market is characterized by small trading volumes (compared to the main European hubs) and relatively high concentration. Market participants usually prefer to hedge longer maturities in more liquid hubs (like TTF) and trade the geographical spread to bring positions to the French market as delivery approaches.

6. Market participants active in PEG contracts can be classified as:

   - Utilities, which have a gas portfolio (entry/exit capacities, storages capacities, consumption clients etc.) and use the market for optimizing or sourcing;

   - Industrial consumers, which are essentially buyers in the wholesale market;

   - Municipalities, which aggregate final consumers and bring their needs to the wholesale market;

   - Operators (Transport system operators, storage system operators, LNG system operators etc.), which enter the system for their own needs or for balancing purposes; or

   - Trading companies which do not have a shipper or supply agreement in the market (banks, commodities traders, investment firms etc.).

7. All the contracts are physically delivered via a nomination to the relevant Transmission System Operator (TSO).

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply calculation methodology

8. Deliverable supply amounts to 171,480,000 MWh.

9. The calculation of the deliverable supply is based on actual daily entry capacities of each of the source type described below to the PEG trading hub. While the capacities of the system are relatively stable during the year, the flows of gas depend on the consumption, which depends on the weather conditions. This calculation takes into account the following sources:

   1) Entry pipeline capacity = 2,192 GWh/d in 2018[4]

   2) LNG import capacity = 1,133 GWh/d[5]

   3) Storage withdrawal capacity = 2,389 GWh/d in 2018[6]

   4) Average indigenous production in 2018 = 2 GWh/d in 2018[7]

10. The total deliverable supply sums up to 5,716 GWh/d. This equates to 171,480,000 MWh per month.

Spot month limit

11. Spot month limit amounts to 26,159,410 MWh, which corresponds to 15% of the deliverable supply.

Spot month position limit rationale

12. The PEG contract is a derivatives contract referring to the future physical delivery of gas into the PEG transmission system.

13. Since the PEG contract is not a food contract, its baseline figure for the spot month, was calculated as 25% of the estimated deliverable supply, i.e. 25% * 171,480,000 MWh = 42,870,000 MWh.

14. There are less than three market makers. Thus, the limit is to be set within a range of 5% - 50%. Spot month is the next calendar month which is available to trade.

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[4] https://www.gie.eu/download/maps/2018/ENTSOG_GIE_SYSDEV_2017-2018_1600x1200_FULL_FINAL_web.pdf
[5] Ibid
[6] Ibid
[7] www.appsso.eurostat.ec.europa.eu; http://wds.iea.org/wds/pdf/Gas_Documentation.pdf, page 48

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. BaFin has applied a reverse interpretation of Article 18(3) of RTS 21 and therefore adjusted the spot month limit downwards; deviation from the baseline needs to be significant as position would otherwise be allowed to hold amount of overall positions;

16. The following factors were considered as not relevant:

- overall open interest

- volatility: it is considered limited; therefore, it seems not relevant to adjust the limit

17. In sum, applying the limit of 15% of deliverable supply seems adequate.

Other months' position limit

Open interest calculation methodology

18. Open interest amounts to 14,817,629 MWh.

19. The open interest value was calculated as the average of the daily open interest of all PEG futures from the 01 August 2019 to 31 October 2019. It was based on data provided by the European Commodity Clearing (ECC), i.e. the CCP of Powernext where the contract used to be traded before it was transferred to EEX in the course of a merger of Powernext with EEX. EEX had not listed the contract until 01 January 2020. From 31 December 2019 to 01 January 2020 all trading at Powernext ceased and started at EEX simultaneously. Accordingly, all positions held at Powernext were completely transferred to EEX.

20. The open interest has been calculated by aggregating all contracts across all maturities and converting them into MWh. Furthermore, the calculation is based on the assumption that the open interest at EEX will remain more or less the same as at Powernext. BaFin is closely monitoring the development of open interest.

Other months' limit

21. Other months limit amounts to 5,186,170 MWh, which corresponds to 35% of the open interest.

Other months' position limit rationale

22. The baseline figure for the other months limit amounts to 25% of open interest, i.e. 3,704,407 MWh.

23. The following factors were considered relevant for adjusting the baseline upwards:

- Article 16(2) of RTS 21: There is a large number of separate expiries in the PEG gas contract. For a given trading day, EEX lists PEG derivative contracts for the next 6 months, the next 7 quarters, the next 6 seasons and the next 6 calendar years. This means that 25 instruments are listed in this market each day. In total, 41 different PEG derivatives instruments can be traded each year.

- Article 18(3) of RTS 21: The overall open interest is significantly lower than the deliverable supply, in accordance with Article 18(3) of RTS 21 the other months limit is therefore to be adjusted upwards.

24. The following factors were considered as not relevant:

- volatility: it is considered limited; therefore it seems not relevant to adjust the limit

25. In sum, applying 35% as the limit seems adequate.

V. ESMA's Assessment

26. This Opinion concerns positions held in natural gas PEG futures contracts.

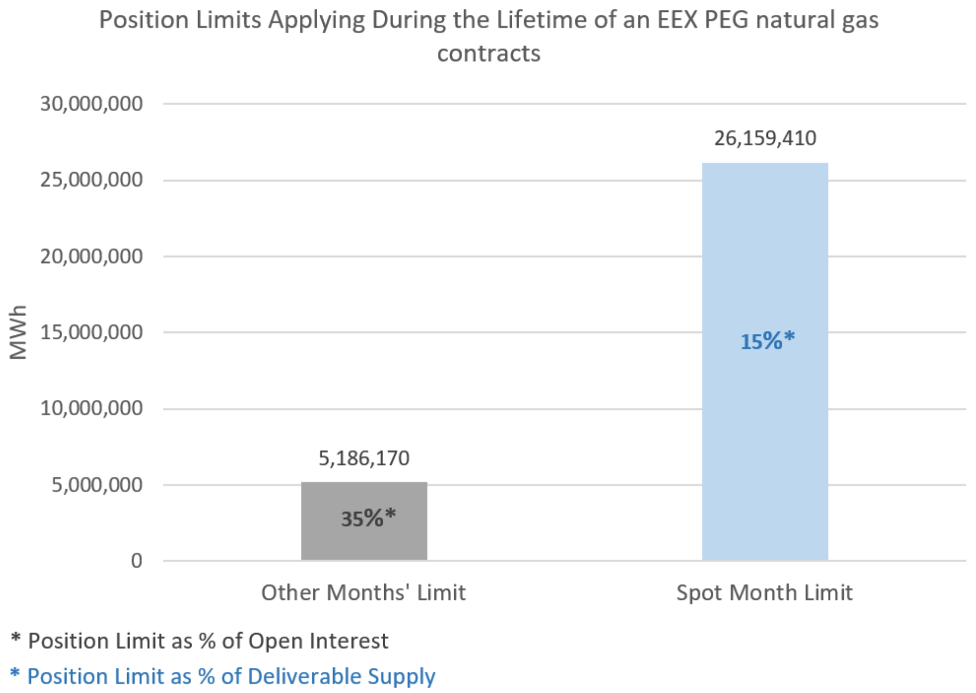
27. ESMA has performed the assessment based on the information provided by BaFin.

28. 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.

29. Since the contract was traded before on Powernext until January 2020, until the merger between EEX and Powernext took place, ESMA considers that this is a continuation of trading in the previously existing contract, rather than the newly created one. Therefore, it seems appropriate to use the previously observed OI level on Powernext, for the purpose of setting the relevant position limits.

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

30. Bafin has set one position limit for the whole spot month and one for the other months.



Spot month position limit

31. The estimation of deliverable supply for natural gas is calculated by aggregating French imports and transmission capacity from neighbouring countries and the average withdrawal rate from storage facilities, as well as the local production.

32. ESMA considers that the deliverable supply calculation's methodology is consistent with Article 10(2) of RTS 21 that 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".

33. Taking into account that the deliverable supply is significantly higher than the open interest, ESMA considers it appropriate to adjust the spot month limit downwards, accordingly to Article 18(3) of the RTS 21.

Other months' position limit

34. The open interest was calculated as the daily average over the period from August to October 2019 of the number of open contracts that have not been closed out or expired. ESMA considers such an approach suitable 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.

35. ESMA notes that pending the preparation of the Competent Authorities for using the data reported according to Article 58 of MIFID II as a source for the calculation of open interest, using the data provided by the trading venues is appropriate.

36. Compared to the baseline figure of 25% of overall open interest, the other months' position limit has been adjusted upward to take into consideration the fact that the open interest is significantly lower than the deliverable supply. This is consistent with Article 18(3) of RTS 21. Additionally, the other months' limit has been adjusted upwards considering large number of separate expiries as per Article 16(2) of RTS 21. Overall, the other months' limit of 35% of the overall open interest seems adequate.

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

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

38. Under Article 57(1) of MiFID II, the objectives of the position limits are to prevent market abuse and support orderly pricing and settlement. Based on the information provided by the competent authority ESMA notes that the spot month limit far exceeds the overall open interest in the PEG natural gas contracts.

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

40. In light of the assessment above, ESMA considers that the position limits set for the spot month and for the other months 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 natural gas market and the liquidity of PEG contracts are not hampered.

41. However, to help ensure that the objectives set out in Article 57(1) of MiFID II are met, ESMA considers that trading patterns in PEG contracts should be carefully monitored by the competent authority, in particular during the spot month, and that the limits should be reviewed on a timely basis.

VI. Conclusion

42. Based on all the considerations and analysis presented above, it is ESMA's opinion that this 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. This other months' position limit does 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