

OPINION on position limits on Dutch Power Physical Base contracts

I. Introduction and legal basis

1. On 6 November 2017, the European Securities and Markets Authority (“ESMA”) received a notification from the Netherlands Authority for the Financial Markets (“AFM”) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments¹ (“MiFID II”) regarding the exact position limits the AFM intends to set for futures in Dutch Power Physical 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: other (OTHR)

Name of trading venue: ICE ENDEX DERIVATIVES B.V.

MIC: NDEX

Venue product codes: DPB, DPW

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

3. The ICE ENDEX DERIVATIVES B.V. contract for Dutch Base Power refers to the trading of power that is both generated in the Netherlands and received from the countries the Netherlands is connected to. The Dutch Power Physical Base contracts are traded in lots for which 1 lot equals 1 MW (1,000,000 Watts). The minimum trading size is 1 lot. There are monthly and weekly future contracts available and the contracts are physically settled. Months, quarters and years are listed in parallel. The delivery is made each hour throughout the delivery period from 00:00 (CET) on the first day of the month (week for weekly futures) until 24:00 (CET) on the last day of the month (week for weekly futures). The contract price is in Euros and Euro cents per MWh.
4. The Dutch market tends to import German wind and solar generation and Norwegian hydropower. The grid currently has interconnectors to four countries: Belgium, Germany, Norway and the UK. There is the 700MW NorNed link to Norway, the 1GW BritNed cable to the UK, two interconnectors to Belgium totalling 2.7GW and three interconnectors to Germany totalling 3GW. Additionally, an interconnector to Denmark is expected to be in operation in early 2019.
5. The Dutch power generation market is moderately concentrated, with four major players: Nuon/Vattenfall, Essent/RWE, E.ON and Electrabel/GDF Suez. Being the second largest gas producer in Europe, the electricity market in the Netherlands has been dominated by gas-fired generation (61%).
6. Changing conditions in the Dutch power and gas markets coupled with policy changes implemented by the government imply that most new capacity will be coal-fired (15%) or based on wind generation (13%). The Netherlands continues to back additional renewable energy resulting in an increase in renewable capacity of 1.5GW in 2016 and this trend is expected to continue in the coming years mainly with the roll-out of offshore wind energy.
7. The power generation from hard coal plants decreased because of the closure and decommissioning of several coal plants. The generation from gas-fired power plants increased significantly, partly to replace the generation from the decommissioned coal plants but more importantly due to the significant increase in margins for electricity generation with gas-fired plants. The share of wind generation increased by about 30% from 2015 to 2016. Demand has been in slight decline over the last few years, partially as a result of high electricity prices and milder winters, but is expected to be increasing again due to economic growth and the expected move from fossil fuels to electricity.

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

8. Deliverable supply amounts to 25,715,520 MWh.
9. The Dutch electricity physical market is part of North-Western Europe (NWE) coupling area. Therefore, the net figure for the total Delivery Supply volume is achieved by adding the Netherlands' own self-electricity generation capacity to the net transmission capacity (NTC) from each interconnector linked to the Netherlands.
10. The Net Generating Capacity (in MW) in 2017 for the Netherlands was 31,749 MW⁴. Given the NWE market mechanism, the quantity of the power that can be used to fulfil the delivery requirements of the various Dutch Power contracts should take into account the local production capacity of the Netherlands as well as of the other countries (Belgium, Germany, Norway and the United Kingdom) for which there is an interconnector to the Netherlands, or net transmission capacity (NTC)⁵.
11. The Dutch Power hub total deliverable supply including NTC as of 2016 is composed as follows: Netherlands (Installed Capacity) 31,749 + Belgium (NTC) 950 + Germany (NTC) 1,468 + Norway (NTC) 533 + United Kingdom (NTC) 1,016 = Total Deliverable Supply of 35,716 MW.
12. Because the Deliverable Supply is calculated per standard month (30 days), the capacity needs to be multiplied by 24 (hours) and 30 (days). Therefore, a unit conversion of 720 is required between the lot size and the underlying deliverable, resulting in an estimation of deliverable supply of 25,715,520 MWh.

Spot month position limit

13. The spot month limit is set at 6,171,725 MWh, which represents 24% of deliverable supply. As currently there are no options listed, this limit applies to Dutch Power Base futures (monthly future and weekly futures).

Spot month position limit rationale

14. The baseline for the other months limit has been set at 25% as required by Article 9(1) of RTS 21. The contract can have a position limit set between 5-50% as set out in Article 19(2)(b) of RTS as there is no investment firm acting as a market maker in accordance with Article 4(1)(7) of Directive 2014/65/EU.
15. AFM considered the following factor relevant for adjusting the baseline downwards:
 - Article 17 of RTS 21: 11% of the total deliverable supply is deliverable supply from interconnectors and can be delivered to other countries.

⁴ <https://transparency.entsoe.eu/generation/r2/installedGenerationCapacityAggregation/show>

⁵ <https://transparency.entsoe.eu/transmission-domain/ntcYear/show>

16. In considering the volatility in the contracts, as required by Article 21 of RTS 21, there has been some variation in the price of the commodity derivative but the AFM has not found evidence that this is excessive or that lower position limits would reduce volatility.
17. All other factors have been considered and were not regarded as material or relevant to require additional adjustments, either up or down, from the baseline.
18. Given the characteristics of this contract, the AFM has decided to set a total downward adjustment of 1-percentage point resulting in an adjusted baseline of 24% of deliverable supply. This provides a figure of 6,171,725 MWh.

Other months' position limit

Open interest

19. The open interest amounts to 25,537,599 MWh. The related contracts that fit the aggregation criteria of identical settlement and delivery terms are Dutch Power Base Load Futures and Dutch Power Base Load Week Futures. There are no EETOC contracts identified by the trading venue.
20. Daily average Open Interest is calculated by adding open interest from each related contract identified that can be aggregated. Open Interest figures are published at ICE Endex website Report Center⁶. The open interest shown corresponds to the daily average over 2016 for all the aggregated contracts.

Other months' position limit

21. The other months limit is set at 8,938,159 MWh, which represents 35% of open interest. As currently there are no options listed, this limit applies to Dutch Power Base futures (yearly, quarterly and monthly futures).

Other months' position limit rationale

22. The baseline for the other months limit has been set at 25% as required by Article 9(1) of RTS 21. The contract can have a position limit set between 5-50% as set out in Article 19(2)(b) of RTS as there is no investment firm acting as a market maker in accordance with Article 4(1)(7) of Directive 2014/65/EU.
23. AFM considered the following factors relevant for adjusting the baseline upwards:
 - Article 16 of RTS 21: This contract has a large number of separate expiries, including amongst others 59 separate expiries of monthly contracts.

⁶ <https://www.theice.com/marketdata/reports/159>

- Article 20(2)(d) of RTS 21: There is a limited number (6) of daily active participants that are involved in trading. In addition, market participants have a relatively large position in the physically delivered power derivatives market and they operate facilities with substantial generation capacity or large demand assets.

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

26. Given the characteristics of this contract, the AFM has decided to set a total upward adjustment of 10 percentage points resulting in an adjusted baseline of 35% of open interest. This provides a figure of 8,938,159 MWh.

ESMA's Assessment

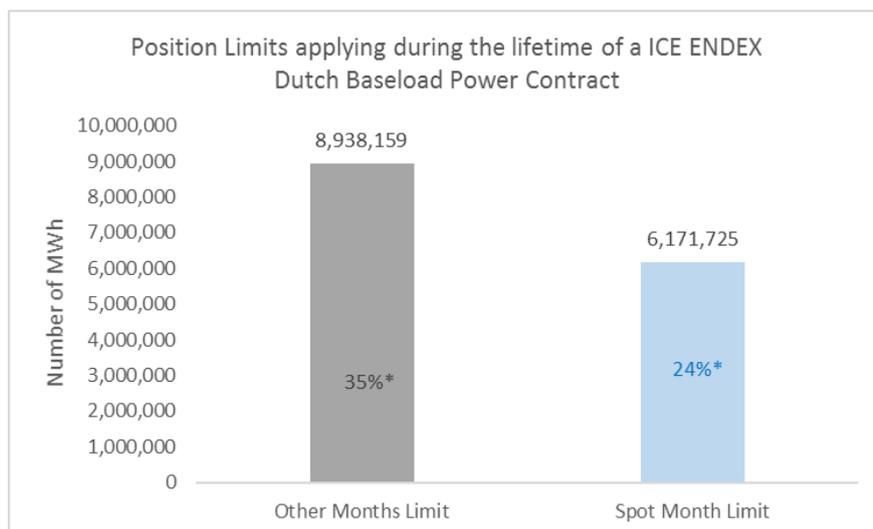
27. This Opinion concerns positions held in Dutch Power Physical Base futures contracts.

28. ESMA has performed the assessment based on the information provided by the AFM.

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.

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

30. The AFM has set one position limit for the spot month and another position limit for the other months.



*Position limit as % of Open

*Position limit as % of Deliverable

Spot month position limit

31. The calculation of the deliverable supply is based on ENTSO-e figures for 2017. ESMA agrees with using data from ENTSO-e to calculate deliverable supply, as this ensures publicly available figures consistent at the European level. ESMA also considers appropriate to including both domestic generation and imports into the Netherlands based on the capacity of the interconnectors of the Netherlands to neighbouring countries, as this energy would also be available for delivery.
32. While the physical delivery of power depends on the actual days of the month, ESMA agrees with using 30 days (average calendar days in a month) and 24h per day to calculate monthly deliverable supply, in order to standardize the monthly deliverable supply of power for these baseload contracts.
33. The approach followed 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”.
34. ESMA agrees with the downward adjustment made by AFM under Article 17 of RTS 21 as 11% of the total deliverable supply comes from interconnectors and can be delivered to other countries.

Other months' position limits

35. ESMA considers that using use a daily average open interest over 2016, which is the latest calendar year for which annual data was available at the time of the notification, is sensible, as it gives a more stable measure of open interest and considers such approach consistent with Article 12 of RTS 21.
36. ESMA agrees with the upward adjustment made under Article 16 given that there are a large number of separate expiries of monthly futures contracts.
37. ESMA also agrees with the upward adjustment made under Article 20(2)(d) given the limited number of market participants and their role in the underlying commodity market.
38. 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

39. ESMA has found no evidence indicating that the proposed position limits are not consistent with the objectives of preventing market abuse and supporting orderly pricing and settlement condition established in Article 57(1) MiFID II.



40. Overall, 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 market and the liquidity of this contract are not hampered.

Conclusion

41. 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 comply with the methodology established in RTS 21 and is consistent with the objectives of Article 57 of MiFID II.

Done at Paris, 18 January 2019

Steven Maijor

Chair

For the Board of Supervisors