

OPINION on position limits on MEFFPOWER Baseload contracts

I. Introduction and legal basis

1. On 14 January 2021, the European Securities and Markets Authority (ESMA) considered that sufficient information was received to assess a notification received from Comisión Nacional del Mercado de Valores (CNMV) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments¹ (“MiFID II”). This notification is regarding the exact position limits CNMV intends to set for the MEFFPOWER Baseload commodity derivative 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.
3. On 20 January 2020, ESMA issued an Opinion regarding the revised position limits CNMV intended to set for the MEFFPOWER Baseload contracts. The position limits considered by CNMV in March 2019 were 10,000,000 MWh for the spot month limit and 3,400,000 MWh for the other months’ limit. In this opinion, ESMA concluded that the position limits considered by CNMV complied with the methodology established in RTS 21 and were consistent with the objectives of Article 57 of MiFID II.
4. According to Article 57(4) of MiFID II, a competent authority shall review position limits where there is a significant change on the market, based on its determination of deliverable supply and open interest and reset the position limit. The CNMV has calculated again the open interest at the end of year 2020 based on position reporting data. The CNMV considered that there had been a significant increase in the open interest compared to its initial submission and that the position limits for the other months had therefore to be reconsidered. ESMA understands that the new position limits will apply upon publication of

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).



this opinion and replace the previous position limits as determined by the CNMV. In this opinion, ESMA is assessing whether the new position limits the CNMV intends to set for the MEFFPOWER Baseload contracts comply with the methodology established in RTS 21 and are consistent with the objectives of Article 57 of MiFID II

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

III. Market description

5. MEFFPOWER Baseload contracts are cash settled derivatives (futures and swaps) settling against the reference daily price of the spot market for the taking and delivery of electricity in Spain.
6. 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 an only complex algorithm provides the programming of taking and delivery of electricity in several European bidding zones.
7. 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, 98% in 2015 and 95% in 2018 and 2019). That is, more than 90% of all the hours, the price in the spot power market is identical in Spain and Portugal.
8. Another way to measure the coupling is that the annual average difference of spot hourly 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.

9. 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. For this reason, the percentage of hours in which the power interconnection Spain-France was congested and the commercial flow of electricity between Spain and France was limited by its capacity was very high, 77,5 % of the hours of 2019. Consequently, Iberian power system is basically considered isolated and MIBEL electricity prices are uncoupled very often with the central European prices, being higher than these for most of the hours.
10. Other important characteristic of the Spanish electricity system is the high proportion of renewable generation capacity from sources like wind power, photovoltaic solar power and solar thermal power, whose fuels (wind and sun) are neither storable nor manageable as gas and coal are. At the end of 2019, wind and solar generation capacity accounted together for the 34,6 % of the overall generation capacity in Spain (peninsula) and those technologies produced the 27,2 % of the total power produced.
11. In Spain, retail demand is seasonal, being higher in extreme weather conditions in summer and winter, and lower in autumns and specially in springs.
12. In addition to these features from MIBEL, it is important to consider the following general characteristics of the power market:
13. 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.
14. 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.
15. Power is a basic product for the standard of living whose demand generally shows a very low elasticity to price: price movements do not lead to significant changes in demand. 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.
16. Then, it is supply that has to be very flexible to match this demand, also due to two other main features:

17. Supply cannot take much advantage of stored power, as the storage is expensive and limited to a very small proportion of the generation capacity, mainly from facilities with pumping technology.
18. There is also a technical need for a continuous balance between supply and demand because if supply doesn't 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.
19. 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 power generation from non-manageable renewable technologies), makes Spanish power a very special commodity. It is only a large surplus on the supply side that avoids an inherent volatility in the spot power market, as typically hourly changes in demand would lead to hourly movements in prices⁴.

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

20. Deliverable supply amounts to 81,800,980 MWh.
21. The deliverable supply was estimated based on statistics provided by ENTSO-e⁵. It is composed of the domestic Net Generating Capacity in Spain and its average yearly import capacities from its neighbouring countries (France and Portugal) as displayed on ENTSO-e Transparency Platform for 2020.
22. The Net Generating Capacity (in MW) in 2020 for Spain was 107,392 MW. Imports Capacity from neighbouring countries (France and Portugal) for 2020 was 4,664 MW, coming up to a total Deliverable Supply of 112,056 MW.
23. 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, resulting in a deliverable supply of 81,800,980 MWh.

Spot month position limit

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

⁵ European Network of Transmission System Operators for Electricity.

24. The spot month limit is 10,000,000 MWh, which represents 12,2% of deliverable supply. The spot month limit is defined by 30 calendar days. The spot month includes daily, weekly and one monthly contract.

Spot month position limit rationale

25. As it is established in Article 57 of MiFID II, the CNMV has set position limits to the maximum net position which a person can hold at all times in MEFFPOWER baseload contracts applying the methodology set out in RTS 21, Chapter III – Methodology for Competent Authorities to calculate position limits.
26. In the first place, Article 15(1)(b) of RTS 21 (New and illiquid contracts) is applicable to the MEFFPOWER baseload contract, because the total open interest of the contract has been over 10.000 lots but not exceeding 20.000 lots for longer than the consecutive three month period stated in the regulation. Consequently, position limits shall be set between 5% and 40% of the corresponding baseline.
27. On the other hand, according to Article 19(2) of RTS 21, competent authorities shall set the spot month and other months' position limit between 5% and 50% if the number of investment firms acting as a market maker in accordance with Article 4(1)(7) of Directive 2014/65/EU in the commodity derivative at the time the position limit is set or reviewed is lower than 3. Since there are no market makers in the MEFFPOWER baseload contract, position limits for this contract shall be set between 5% and 50% and CNMV made use of the extended range.
28. From the baseline figure of 25% of the delivery supply, the CNMV has applied the following downward adjustment factor foreseen in RTS 21 in order to set the bespoke spot month position limit.
29. Deliverable supply in Spanish power is more than 8 times larger than open interest in MEFFPOWER contract. Based on the rationale of Article 18(3) of RTS 21 it is therefore legitimate to adjust the spot month limit downward in order to mitigate to a certain extent the cliff effect when the position in the contract moves from the other months to the spot month.
30. 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 CNMV has not found evidence that this is excessive or that lower position limits would reduce volatility.
31. 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.
32. Based on the above, CNMV has decided to set a total downward adjustment of 12.8 percentage points resulting in an adjusted baseline of 12.2% of deliverable supply. This provides a rounded figure of 10,000,000 MWh.



Other months' position limit

Open interest

33. The open interest amounts to 10,184,962 MWh. The open interest for every holder is the aggregation (in units of underlying MWh) of all the derivatives (futures and swaps) on Spanish baseload contracts of power registered as traded in MEFFPOWER. The source of the data is the daily position reporting of MEFFPOWER that is received by the CNMV.

34. The open interest has been calculated as the daily average of total open interest in MEFFPOWER baseload contracts from 1 October 2019 to 30 September 2020. The absolute values of daily net positions per position holder have been added up and divided by the factor 2 ("net approach"). The figure for the daily calculation aggregates the position in all the contracts previously referred: 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

35. The other months limit amounts to 5,000,000 MWh, which represents 49,1% of the open interest.

Other months' position limit rationale

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

37. The CNMV has considered the following factors relevant for adjusting the other months' limit upwards:

- Article 16 of RTS 21: There is large number of separate expiries open for registration, which number fluctuates from a minimum of 70 to a maximum of 100. Currently, the contract registered in MEFFPOWER Spanish Baseload contracts with the furthest expiry is the calendar year 2030.
- Article 18(3) of RTS 21: The overall open interest is significantly lower than deliverable supply. Deliverable supply is more than 8 times larger than the overall open interest.

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

39. 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.



40. Based on the above, the CNMV has decided to set a total upward adjustment of 24,1 percentage points resulting in an adjusted baseline of 49,1% of open interest. This provides a figure of 5,000,000 MWh.

V. ESMA's Assessment

41. This Opinion concerns positions held in MEFFPOWER Baseload contracts.

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

43. 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.

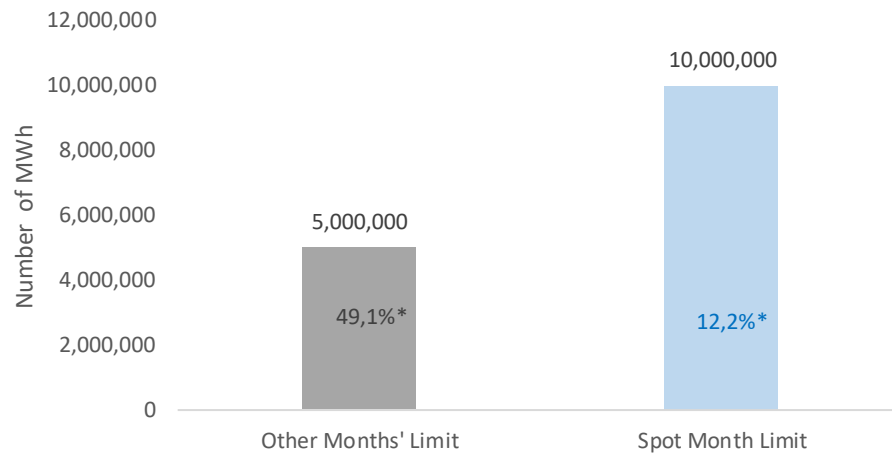
44. The overall open interest in the MEFFPOWER Baseload contracts for the contract amounts to 10,184,962 MWh, which translates into 14,146 lots. Since the level of open interest is between 10,000 lots and 20,000 lots and there are less than three market makers active in the contract, the spot month and the other months' limits can be set between 5% and 50% of the reference amount in accordance with Article 19(2) of RTS 21.

45. 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

46. 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 limits applying during the lifetime of a MEFFPOWER Spanish Baseload Contract



*Position limit as % of Open Interest

*Position limit as % of Deliverable Supply

Spot month position limit

47. The deliverable supply was estimated based on ENTSO-e data. It is composed of the average Spanish domestic Net Generating Capacity (NGC) and of Import capacity to Spain from France and Portugal for year 2020. This ensures publicly available figures consistent at the European level.
48. 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.”
49. The monthly deliverable supply figure has been calculated by converting the capacity (expressed in MW) to MWh per month.
50. 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”.
51. 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



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

Other months' position limit

52. The open interest has been calculated by CNMV as the daily average of total open interest in MEFFPOWER Spanish Baseload contracts from 1 October 2019 to 30 September 2020 based on position reporting data where the daily net positions have been added up and divided by the factor 2 ("net approach"). ESMA considers that such calculation of open interest by the competent authority provides the most accurate and reliable figure and promotes convergence in the setting of position limits by competent authorities. ESMA is also of the view that taking 1 October 2019 to 30 September 2020 as a reference period is 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.

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

54. 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.

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

56. 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.

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

57. 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.

58. 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 2020.

59. 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.



60. 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 MEFFPOWER Baseload Futures contract are not hampered.

61. 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

62. 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