European Securities and Markets Authority

Date: 24 February 2021
ESMA70-155-11742

OPINION on position limits on PXE Czech Financial Baseload contracts

I. Introduction and legal basis

1. On 2 February 2021, the European Securities and Markets Authority (ESMA) considered that sufficient information was received to assess a notification from the Federal Financial Supervisory Authority ("BaFin") under Article 57(5) of Directive 2014/65/EU on markets in financial instruments[1] ("MiFID II"). The notification is regarding the exact position limits BaFin intends to set for the PXE Czech Financial Baseload Future 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.

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 23 May 2019, ESMA issued a first opinion regarding the exact position limits BaFin intended to set for the PXE Czech Financial Baseload Future commodity contract. The position limits considered by BaFin in January 2018 were 3,446,281 MWh for the spot month limit and 4,176,845 MWh for the other months' limit. In this opinion, ESMA concluded that the position limits considered by BaFin 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 in deliverable supply or open interest, or any other significant change on the market, and reset the position limits. Whereas the open interest underpinning the position limits set out in BaFin's initial submission had been calculated based on the information provided by the trading venue, BaFin has now calculated again the open interest based on position reporting data. Consequently, BaFin considered that since there had been

[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).

a significant decrease in the open interest compared to its initial submission, the position limit had to be reset for both the spot month limit and the other months' limit. ESMA understands that the new position limits will apply after the date of the issuance of ESMA opinion on those revised position limits. The new limits are replacing the previous position limits as determined by BaFin from the date of their application.

5. In the opinion herewith, ESMA is assessing whether the new position limits BaFin has set for the PXE Czech Financial Baseload Future commodity contract 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: baseload (BSLD)

Name of trading venue: EUROPEAN ENERGY EXCHANGE

MIC: XEEE

Venue product code: FXB

III. Market description by the competent authority

6. The PXE Czech Financial Baseload Futures contract is a cash-settled derivative contract referring to the average power spot market price of future delivery periods of the Czech market area. Formerly, the contract was traded at Power Exchange Central Europe (PXE). In the course of EEX's acquisition of PXE the contract has been migrated from PXE to EEX. The contracts are traded in lots for which one lot equals 1 MW. Days, weekends, weeks, months, quarters and years are listed in parallel.

7. 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 or higher demand in summer due to air-conditioning, electricity generation tends to be higher in times of climatic extremes. However, such seasonal effects are rather small.

8. Power generation capacity is a relatively concentrated market in Czechia. ČEZ, a.s. is the country's main electricity generation company. The ČEZ, a.s. group is also active in other Eastern European power markets, making it one of the ten biggest European Energy

companies. ČEZ, a.s. is substantially owned by the Czech Government, with around 70% shares in government hands.

9. However, in the last years market concentration has significantly decreased. Furthermore, the interconnectivity level of the Czech power grid is currently at 19,3% of entire capacity, making it one of the highest in the EU. Cross-border-interconnections exist with all neighbouring countries, i.e. Germany, Poland, Slovakia and Austria. The Czech Republic is one of the so called 4M Market Coupling (4M MC) countries, namely the Czech Republic, Hungary, Romania and Slovakia. This is an interconnection of the spot markets of these countries (OTE in Czech Republic, HUPX in Hungary, OPCOM in Romania and OKTE in Slovakia). Prices and net transfers are determined using a common algorithm, based on the order books and available transmission capacities.

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

10. Deliverable supply amounts to 18,703,938 MWh.

11. The deliverable supply was estimated based on statistics provided by ENTSO-E (European Network of Transmission System Operators for Electricity). It is composed of the domestic Net Generating Capacity (NGC) of Czechia as displayed on the website of ENTSO-E for the years 2019 and 2020. These values have been converted from yearly MW to MWh. The overall value was then divided by the factor of 12 to align the deliverable supply to the time frame of one calendar month for the spot month period.

Spot month limit

12. The spot limit has been set at 1,870,394 MWh, which represents 10% of the deliverable supply. It includes daily contracts, weekend contracts, week contracts, and monthly contract.

Spot month position limit rationale

13. Since the PXE Czech Financial Baseload Futures 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, i.e. 25%*18,703,938 MWh = 4,675,985 MWh.

14. The following factors were considered relevant for adjusting the limit downwards:

- the deliverable supply is significantly higher than the open interest, in accordance with Article 18(3) of RTS 21 the spot month limit is therefore to be adjusted downwards as position holders would otherwise be allowed to hold excessive amounts of overall positions;

- characteristic of market of the underlying: with CEZ there is one key market player that still dominates parts of the underlying power spot market which is to be taken into account under Art. 20 (2) (d) and (e) of RTS 21.

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

16. In sum, applying 10% as limit seems adequate.

Other months' position limit

Open interest

17. Open interest amounts to 8,594,111 MWh. Whereas the open interest of the previous position limit was calculated on basis of information from the trading venue, the open interest for the position limit at hand has been calculated on basis of the reports of daily net positions submitted to BaFin pursuant to Article 58 MiFID II.

18. The daily net positions have been added up and divided by the factor 2 ("net approach"). The number provided is the average size of daily open interest calculated on basis of daily reports from December 2019 till end of November 2020.

Other months' limit

19. The other months' limit has been set at 3,437,644 MWh, which represents 40% of open interest. It includes monthly (other than spot month), quarterly and yearly contracts.

Other months' position limit rationale

20. The baseline figure for the other months limit amounts to 25% of open interest, i.e. 2,148,528 MWh.

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

- 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.

- maturity: upward adjustment due to large number of separate expiries (seven monthly contracts, seven quarterly contracts and six yearly contracts; in contrast to daily and weekly contracts, monthly, quarterly and yearly contracts are traded in significant volumes.

22. The following factors were considered relevant for adjusting the limit downwards:

- characteristic of market of the underlying: with CEZ there is one key market player that still dominates parts of the underlying power spot market which is to be taken into account under Article 20 (2)(d) and (e) of RTS 21.

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

24. In sum, applying 40% as limit seems adequate.

V. ESMA's Assessment

25. This Opinion concerns positions held in PXE Czech Financial Baseload Futures contracts.

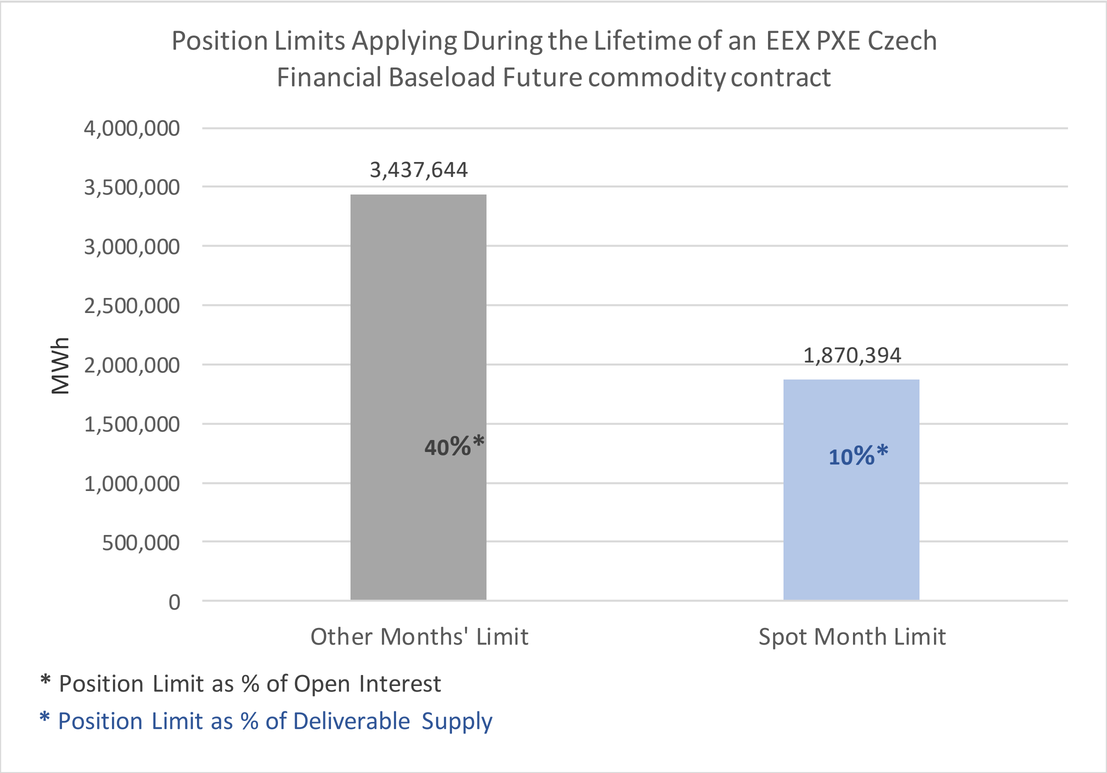
26. ESMA has performed the assessment based on the information provided by BaFin.

27. 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.

28. The overall open interest for the contract amounts to 8,594,111 MWh, which translates into 11,936 lots. Since the level of open interest is between 10,000 lots and 20,000 lots, the limit shall be set between 5% and 40% of the reference amount, according to Article 15(1)(b) of RTS 21.

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

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



<u>Spot month position limit</u>

30. The calculation of the deliverable supply is based on ENTSO-e figures for 2020. 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 Czechia based on the capacity of the interconnectors of Czechia to neighbouring countries, as this energy would also be available for delivery.

31. This approach 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”.

32. The monthly deliverable supply figure has been calculated by converting the capacity (expressed in MW) to MWh per month. Given the characteristics of the contract (i.e. delivery of electricity 24 hours per day during every day of the delivery period), this conversion is performed as follows: monthly deliverable supply (in MWh) = total capacity (in MW) x 24 hours x 365 days / 12 months.

33. ESMA also agrees with the downward adjustments made by BaFin to the spot month limit under Articles 18(3) because of the difference between the deliverable supply and the open interest and with the downward adjustment factor under Article 20(2)(d) and (e) of RTS 21,

because of the dominant position of CEZ in Czechia and the need to have measures to limit large speculative positions in the derivatives market.

<u>Other months' position limit</u>

34. The open interest has been calculated by BaFin based on position reporting data where the daily net positions have been added up and divided by the factor 2 ("net approach"). The number provided is the average size of daily open interest from December 2019 till end of November 2020.

35. 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 the period from December 2019 to November 2020 as a reference is sensible in this case as an average for a longer period of time gives a more stable measure of open interest and considers such approach consistent with Article 12 of RTS 21.

36. ESMA considers as a reasonable approach to have adjusted upwards the limit under the Article 18(3) of RTS 21 taking into account the difference between the level of deliverable supply and the open interest. ESMA also agrees with the upward adjustment under Article 16(2) due to large number of separate expiries.

37. ESMA also considers that the downward adjustment under Article 20(2)(d) and (e) is appropriate given the dominant position of one key market player in the underlying power spot 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 conditions established in Article 57(1) MiFID II.

40. Overall, the position limits set for the spot month and 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 power market and the liquidity of the PXE Czech Financial Baseload Futures contract are not hampered.

VI. Conclusion

41. 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