

## OPINION on position limits on EEX Italian Power Base contracts

### I. Introduction and legal basis

1. On 4 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<sup>1</sup> (“MiFID II”). The notification is regarding the exact position limits that BaFin intends to set for EEX Italian Power Base Futures and Options 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<sup>2</sup> (“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)<sup>3</sup> (“ESMA Regulation”), the Board of Supervisors has adopted this opinion.
3. On 6 September 2019, ESMA issued a first opinion regarding the exact position limits BaFin intended to set for the EEX Italian Power Base Futures and Options commodity contract. The position limits considered by BaFin in October 2017 were 26,579,658 MWh for the spot month limit and 125,074,460 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 a significant decrease in the open interest compared to its initial submission, the position limit

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<sup>1</sup> 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).

<sup>2</sup> 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).

<sup>3</sup> 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).



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 EEX Italian Power Base Futures and Options 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: Base Load (BSLD)

Name of trading venue: EUROPEAN ENERGY EXCHANGE

MIC: XEEE

Venue product codes: FDB, ODB

## **III. Market description**

6. The EEX Italian Power Base Future and Option is a derivative contract referring to the average power spot market price of future delivery periods in the Italian market area. The contract is cash-settled.
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 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 and air-conditioning demand in summer, electricity generation tends to be higher in those seasons. However, such seasonal effects are small.
8. The Italian electricity market is well connected with the grids of its neighbouring countries, including non-EU countries in Northern Africa. For the coming years, an increase of the interconnectivity level is to be expected as currently substantial investments in infrastructure projects are under way.
9. Italy's power generation capacity stems from various sources of which renewable energy becomes increasingly important. To meet the EU renewable energy targets, Italian electricity regulations give priority to energy produced by renewable energy sources. The Italian

regulatory authority for energy, networks and environment (ARERA) is the independent body that regulates, controls and monitors the electricity market in Italy. The sole operator of the national power transmission system is Terna that operates around 98% of the Italian high-voltage power transmission grid. The most important shareholder is the Italian State via Cassa Depositi e Prestiti.

10. The underlying of the EEX Italian Power Base contract is the delivery or acceptance of delivery of Italian electricity with a constant output of 1 MW during the delivery time (00:00 until 24:00) on every day of the week during the delivery period. The possible delivery periods for this contract are: day, weekend, week, month, quarter and year.
11. With respect to EEX Italian Power Base futures contracts, at maximum, the following maturities can be traded: for “Day Futures” the respective next 34 days; for “Weekend Futures” the respective next 5 weekends; for “Week Futures” the current and the next 4 weeks; for “Month Futures” the current and the next 6 months; for “Quarter Futures” the respective next 7 full quarters; and for “Year Futures” the respective next 9 full years.
12. EEX offers trading in options on the Italian Base futures contracts (Month, Quarter, Year). Regardless of the different maturities, the corresponding futures position of the underlying asset is booked upon exercising the option.
13. With respect to options on the Italian Power Base futures, at maximum, the following maturities can be traded: the next 9 delivery months, the next 6 delivery quarters, the next 4 delivery years.

#### **IV. Proposed limit and rationale by the competent authority**

##### *Spot month position limit*

##### Deliverable supply

14. Deliverable supply amounts to 97,814,924 MWh.
15. 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 Italy as displayed in the Statistical Factsheet of ENTSO-E for the year 2018<sup>4</sup> and the average yearly import capacities of Italy in relation to neighbouring countries as displayed on the ENTSO-E transparency website for forecasted transfer capacities in 2019 and 2020<sup>5</sup>.

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<sup>4</sup> [https://eepublicdownloads.entsoe.eu/clean-documents/Publications/Statistics/Factsheet/entsoe\\_sfs2018\\_web.pdf](https://eepublicdownloads.entsoe.eu/clean-documents/Publications/Statistics/Factsheet/entsoe_sfs2018_web.pdf). At the time the data was collected, the most recent version of the statistical factsheet was for the year 2018.

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

16. The values provided by ENTSO-E have been converted from MW to MWh per year. The overall value was then divided by 12 in order to align the deliverable supply to the timeframe of the spot month period, i.e. one calendar month.

#### Spot month position limit

17. The spot month limit has been set at 14,672,239 MWh, which represents 15% of the reference amount. The spot month limit applies to the EEX Italian Power Base Futures and Options. It includes daily contracts, weekend contracts, weekly contracts and one monthly contract.

#### Spot month position limit rationale

18. The baseline figure for the spot month limit amounts to 25% of the deliverable supply, i.e. 24,453,731 MWh, as required by Article 9(1) of RTS 21.

19. There are three active market makers. However, none of them is an investment firm. Thus, the limit is to be set within a range of 5% - 50%.

20. BaFin considered the following factor relevant for adjusting the baseline downwards:

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

21. All other factors have been considered by BaFin and are not regarded as material or relevant to require additional adjustments, either up or down, from the baseline. 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 BaFin has not found evidence that this is excessive or that lower position limits would reduce volatility.

22. Based on the above, BaFin considers that applying 15% as a limit for the spot month seems adequate.

#### *Other months' position limit*

#### Open interest

23. The open interest amounts to 59,768,948 MWh.

24. Whereas the open interest of the previous position limit was calculated on basis of information from the trading venue, the open interest for this position limit has been calculated on basis of the reports of daily net positions submitted to BaFin pursuant to Article 58 of MiFID II. 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 January to June 2020. Option positions reported to BaFin are delta adjusted.

### Other months' position limit

25. The other months' limit has been set at 17,930,684 MWh, which constitutes 30% of the reference amount. The other months' limit applies to the EEX Italian Power Base Futures and Options. It includes monthly, quarterly and yearly contracts.

### Other months' position limit rationale

26. The baseline figure for the other months' limit amounts to 25% of open interest, i.e. 14,942,237 MWh, as required by Article 11(1) of RTS 21.

27. BaFin considered the following factor relevant for adjusting the baseline upwards:

- Article 16(2) of RTS 21: there is a large number of separate expiries (seven monthly contracts, seven quarterly contracts and six yearly contracts);
- Article 18(3) of RTS 21: the overall open interest is significantly lower than the deliverable supply.

28. All other factors have been considered by BaFin and are not regarded as material or relevant to require additional adjustments, either up or down, from the baseline. 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 BaFin has not found evidence that this is excessive or that lower position limits would reduce volatility.

29. Based on the above, BaFin considers that applying 30% as a limit for the other months is adequate.

## **V. ESMA's Assessment**

30. This Opinion concerns positions held in EEX Italian Power Base Futures and Options contracts.

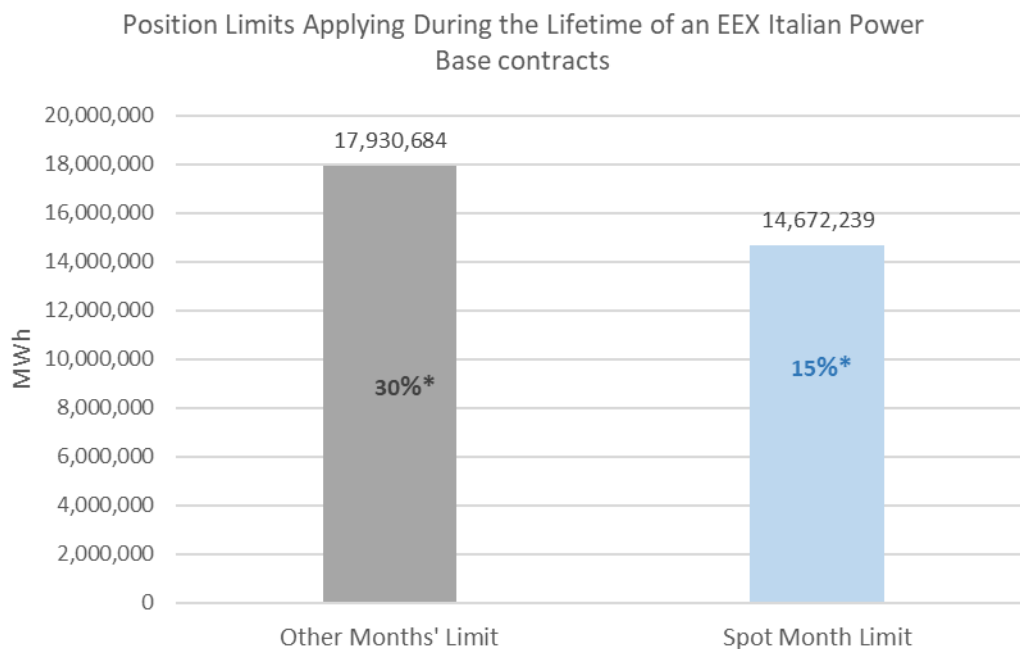
31. ESMA has performed the assessment based on the information provided by the BaFin.

32. 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.

33. The overall open interest for the contract amounts to 59,768,948 MWh, which translates into 83,012 lots.

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

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



\* Position Limit as % of Open Interest

\* Position Limit as % of Deliverable Supply

Spot month position limit

35. The calculation of the deliverable supply is based on the domestic Net Generating Capacity (NGC) of Italy for the year 2018 and the average import capacity in relation to neighbouring countries forecasted in 2019 and 2020. The source of data used to calculate deliverable supply (ENTSO-e statistics) ensures publicly available figures that are consistent at the European level.

36. ESMA considers that this methodology 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.”

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

38. 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”.
39. Compared with the baseline figure of 25% of deliverable supply, the spot month position limit has been adjusted downwards and set at 15% of deliverable supply.
40. The spot month limit has been adjusted downwards 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.

#### Other months' position limit

41. 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 January to June 2020.
42. 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 January to June 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.
43. Compared to the baseline figure of 25% of overall open interest, the other months' position limit has been adjusted upwards and set at 30% of the open interest.
44. 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. ESMA also agrees with the upward adjustment under Article 16(2) due to large number of separate expiries.
45. 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*

46. 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.
47. 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.

48. 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.

49. 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 EEX Italian Power Base contracts are not hampered.

50. 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 EEX Italian Power Base contracts 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**

51. 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,

Steven Maijor

Chair

For the Board of Supervisors