

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

### **I. Introduction and legal basis**

1. On 20 October 2017, the European Securities and Markets Authority (“ESMA”) received 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”) 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.

### **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

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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).

### III. Market description

3. The EEX Italian Power Base Future is a derivative contract referring to the average power spot market price of future delivery periods of the Italian market area. The contract is cash-settled.
4. 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.
5. The Italian electricity market is well connected with the grids of its neighbouring countries, including non-EU countries in Northern Africa.
6. Italy's power generation capacity stems from various sources of which renewable energy becomes increasingly important. In 2015 its electricity production mix was comprised of 15% coal, 39% natural gas, 7% oil and 39% renewables. To meet the EU renewable energy targets, Italian electricity regulations give priority to energy produced by renewable energy sources. The Electricity and Gas Authority (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.
7. Power generation is mainly in the hands of several major entities, e.g. Enel, the former state monopolist, Eni and Edison. The biggest six operators produce nearly 50% of the Italian power generation. Compared to other countries in the EU the average price of electricity is relatively high.
8. 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.
9. 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 6 full years.

10. 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.
11. With respect to options on the Italian Power Base futures, at maximum, the following maturities can be traded: the next 5 delivery months, the next 2 delivery quarters, the next 2 delivery years.

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

##### *Spot month position limit*

##### Deliverable supply

12. Deliverable supply amounts to 98,443,177 MWh.
13. 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)<sup>4</sup> of Italy as displayed in the Statistical Factsheet of ENTSO-E for the year 2016 and the average import capacities in relation to neighbouring countries as displayed on the ENTSO-E transparency website for forecasted transfer capacities in 2016<sup>5</sup>.
14. 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

15. The spot month limit has been set at 26,579,658 MWh, which represents 27% 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

16. The baseline figure for the spot month limit amounts to 25% of the deliverable supply, i.e. 24,610,794 MWh, as required by Article 9(1) of RTS 21.
17. There are 3 market makers active. However, none of them is an investment firm. Thus, the limit is to be set within a range of 5% - 50%.
18. BaFin considered the following factor relevant for adjusting the baseline upwards:

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

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

- Article 20(2)(d) of RTS 21: upward adjustment due to the lack of storage capacity, leading the underlying market to be less prone to market manipulation.

19. 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.

20. In sum, BaFin considers that applying 27% as a limit for the spot month seems adequate.

#### *Other months' position limit*

#### Open interest

21. The open interest amounts to 543,802,000 MWh.

22. The open interest value was provided by the exchange. It was calculated by aggregating all contracts across all maturities and converting them to MWh. The number provided is the average size of daily open interest throughout three consecutive months, namely May, June and July 2017. Option position values have been delta-adjusted.

#### Other months' position limit

23. The other months' limit has been set at 125,074,460 MWh, which constitutes 23% 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

24. The baseline figure for the other months' limit amounts to 25% of open interest, i.e. 135,950,500 MWh, as required by Article 11(1) of RTS 21.

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

- Article 18(2) of RTS 21: the open interest is significantly higher than the deliverable supply (the open interest is more than five times higher than the deliverable supply);

26. 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.

27. In sum, BaFin considers that applying 23% as a limit for the other months seems adequate mainly because the open interest is higher than the deliverable supply.

## V. ESMA's Assessment

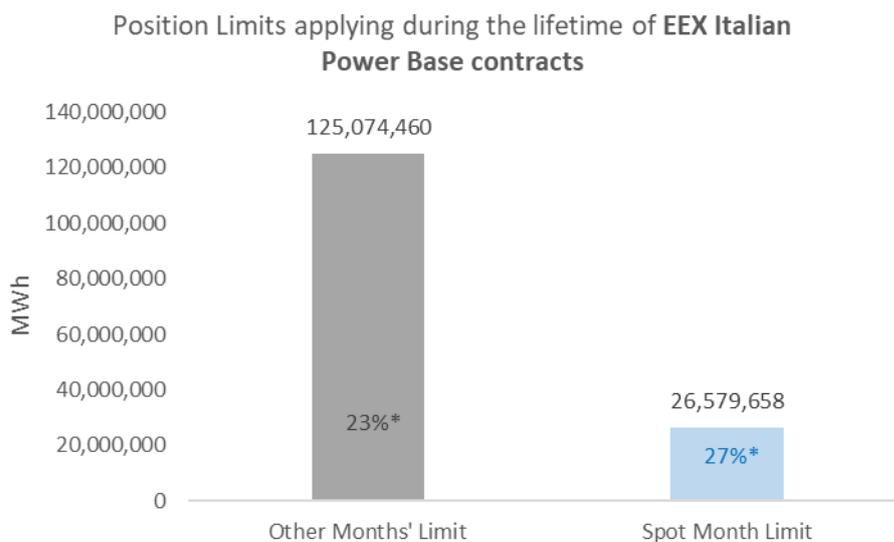
28. This Opinion concerns positions held in EEX Italian Power Base Futures and Options contracts.

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

30. 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*

31. 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

32. The calculation of the deliverable supply is based on the domestic Net Generating Capacity (NGC) of Italy for the year 2016 and the average import capacity in relation to neighbouring countries forecasted in 2016. The source of data used to calculate deliverable supply (ENTSO-e statistics) ensures publicly available figures that are consistent at the European level.

33. 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.”
34. The monthly deliverable supply figure has been calculated by converting the capacity (expressed in MW) to MWh per month.
35. 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”.
36. Compared with the baseline figure of 25% of deliverable supply, the spot month position limit has been adjusted upwards and set at 27% of deliverable supply.
37. ESMA considers as a reasonable approach to have slightly adjusted the spot month limit upwards under Article 20(2)(d) of RTS 21 to take into account the lack of possibility to store the underlying market, which makes it less prone to market manipulation.

#### Other months' position limit

38. The open interest was calculated as the daily average over three consecutive months of the number of open contracts that have not been closed out or expired. ESMA considers such an approach 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.
39. Compared to the baseline figure of 25% of overall open interest, the other months' position limit has been adjusted downward and set at 23% of the open interest.
40. ESMA agrees that a downward adjustment of the other months' position limit is justified in accordance with Article 18(2) of RTS 21 given that the open interest is significantly higher than the deliverable supply.
41. 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*

42. 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) of MiFID II.
43. Overall, the position limit set for the spot month and the other months appear to achieve a reasonable balance between the need to prevent market abuse and to ensure orderly pricing and orderly settlement, while also ensuring that the development of commercial activities in



the underlying market and the liquidity of the EEX Italian Power Base contract are not hampered.

## **VI. Conclusion**

44. 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, 6 September 2019

Steven Maijoor

Chair

For the Board of Supervisors