European Securities and Markets Authority

Date: 15 April 2019
ESMA70-155-2935

OPINION on position limits on Phelix DE/AT Power Peak Futures contract

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[1] ("MiFID II") regarding the exact position limits the BaFin intends to set for the Phelix DE/AT Power Peak Futures commodity contract 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.

II. Contract classification

Commodity base product: energy (NRGY)

Commodity sub product: electricity (ELEC)

Commodity further sub product: peak load (PKLD)

Name of trading venue: EUROPEAN ENERGY EXCHANGE

MIC: XEEE

Venue product code: F1P

[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 December 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).

III.Market description

3. 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. Furthermore, prices of derivatives markets are closely related to spot markets. There are also some seasonal effects in the electricity market. Due to heating demand in winter or air-conditioning demand in summer, electricity generation tends to be higher in times of climatic extremes. However, such seasonal effects are small.

4. Since the electricity system constitutes critical infrastructure, power markets in Germany and Austria are 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.

5. There is a high number of producers and their role in the market is very diverse. In Germany about 700 companies are holding a license to supply electricity to retail clients. Germany is currently in a process of fundamental market design changes ('Energiewende'). At the same time, more and more renewable energy generation facilities and new generation companies are entering the market. The market is thus becoming increasingly diverse, a trend that is further demonstrated by the recent decision of former German market leaders RWE and E.ON to split their businesses to focus on conventional energy business on the one hand and the renewable business on the other hand.

6. Recently, the Monopolies Commission has submitted its Special Report on the development of competition in the market of grid-bound electricity[4]. Based on the assessment of the so called Residual Supply Index and the Return on Withholding Capacity Index by means of which market power has been examined, it has concluded that since 2012 Germany's four biggest energy producers do not have a dominant position on the market anymore.

7. The Phelix DE/AT Power Futures contracts are derivatives contracts referring to the average power spot market prices of future delivery periods of the German/Austrian market area. The underlying of these contracts is the Physical Electricity Index determined by EPEX Spot Exchange on a daily basis. Trading participants have the option of arranging the physical delivery of power on the spot market. EEX offers trading in Phelix DE/AT Power Baseload, Peak and Off-Peak Futures contracts

8. The Phelix DE/AT Power Peak Futures contact is the average price of the hours 8 to 20 for electricity traded on the spot market. It is calculated for all days Monday through Friday in the market area Germany / Austria. Maturities offered for trading comprise Week, Month, Quarter and Year Futures.

[4] https://www.monopolkommission.de/images/PDF/SG/s77_volltext.pdf

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

9. Deliverable supply amounts to 61,613,904 MWh.

10. 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 Germany and Austria as displayed on the ENTSO-E website for the year 2017 and the average yearly import capacities of these countries for 2017. As the peak load contract is solely composed of contracts for a delivery period of only 12 hours a day and only five days a week, the MW amounts have been converted to MWh per year by multiplying them by the factor 3024 (252 business days x 12 hours) to calculate the deliverable supply for the entire year 2017. This number has been divided by 12 in order to get the figure for the spot month period.

Spot month position limit

11. The spot month limit is set at 15,403,476 MWh, which represents 25% of delivery supply.

Spot month position limit rationale

12. The Phelix DE/AT Power Peak Futures contract is classified as a 'liquid' contract with a baseline limit of 25%. The baseline was calculated as 25% of the estimated deliverable supply, i.e. 25% * 61,613,904 MWh = 15,403,476 MWh.

13. All factors have been considered by BaFin and are not regarded as material or relevant to require 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

14. Based on the above and taking into account the characteristics of the contract, BaFin has decided to keep the spot month limit at 25% of deliverable supply. This results in a spot month limit of 15,403,476 MWh.

Other months' position limit

Open interest

15. The open interest amounts to 78,400,000 MWh. Open interest value was provided by the exchange and 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 (May, June, July 2017) to better reflect the declining open interest

in the Phelix DE/AT Power Peak Futures contract since the launch of the Phelix Base DE Power Futures contract.

Other months' position limit

16. The other months' limit is set at 19,600,000 MWh, which represents 25% baseline of open interest.

Other months' position limit rationale

17. The baseline for the other months limit has been set at 25% as required by Article 9(1) of RTS 21.

18. All potential adjustment factors set out in RTS 21 have been considered by BaFin and are not regarded as material or relevant to require 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.

19. Based on this above, and taking into account the characteristics of the contract, BaFin has decided to keep the other months' limit at 25% of open interest. This results in an other months' limit of 19,600,000 MWh.

V. ESMA's Assessment

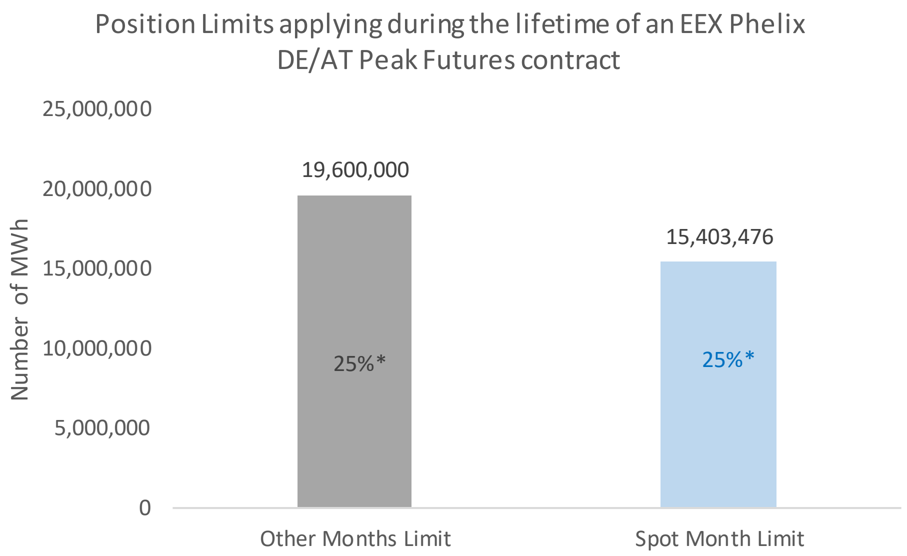
20. This Opinion concerns positions held in Phelix DE/AT Power Peak Futures contract.

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

22. 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

23. BaFin has set a single position limit for both the whole spot month and for the other months



*Position limit as % of Open Interest

*Position limit as % of Deliverable Supply

<u>Spot month position limit</u>

24. 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.

25. ESMA also agrees with the methodology used to include both domestic generation plus imports into Austria and Germany, as 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”.

26. ESMA also agrees with the use of 252 business days per year and 12h per day to convert the MW amounts in MWh per year, then divided by 12 to calculate the monthly deliverable supply for this peak load contract. 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”.

27. Taking into account the potential adjustment factors, ESMA considers as a reasonable approach not to have made any upward or downward adjustment and to have set the spot month limit at the baseline.

<u>Other months’ position limits</u>

28. The open interest was calculated as the daily average during three months in 2017 of the number of open contracts that have not been closed out or expired. ESMA considers such an approach sensible in this case as it allows better taking into account the declining trend in open interest in the contract. ESMA also considers such approach consistent with Article 12 of RTS 21

29. Taking into account the potential adjustment factors, ESMA considers as a reasonable approach not to have made any upward or downward adjustment and to have set the spot month limit at the baseline.

30. 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

31. 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.

32. 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 power market and the liquidity of the Phelix DE/AT Power Peak Futures contracts are not hampered.

VI. Conclusion

33. 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, 15 April 2019

Steven Maijoor

Chair

For the Board of Supervisors