

## OPINION on position limits on EEX French 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 BaFin intends to set for the French 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 code: F7, O7

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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 French Power Base Future is a derivative contract referring to the average power spot market price of future delivery periods of the French market area. The contract can be either physically delivered or 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 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 small.
5. According to DG Energy's country report on France<sup>4</sup> both wholesale and retail electricity markets are highly concentrated. The French electricity market is characterised by the dominant position of Electricité de France (EDF) which is the country's main electricity generation and distribution company. It manages the country's 58 nuclear power reactors that were producing about 72% of the country's total electricity production in 2016, which is the highest share of nuclear power in the world. Renewables and fossil fuels accounted for 17.8% and 8.6% of the production of electricity in France.
6. In 2016 France exported 71,7 TWh whereas the imports amounted only to 32,6 TWh. EDF is substantially owned by the French Government, with around 85% shares in government hands. Moreover, RTE (Réseau de Transport d'Electricité) which owns and manages the electricity transmission network, is majority-owned by EDF. However, compared to other countries in the EU the average price of electricity is relatively low.
7. The wholesale market in France has low liquidity with the majority of trading taking place OTC.
8. The underlying of the French Power Base Contract is the delivery or acceptance of delivery of French 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 French 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.

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<sup>4</sup> <https://ec.europa.eu/energy/en/topics/markets-and-consumers/single-market-progress-report>

10. EEX offers trading in options on the French Base Future (Month, Quarter, Year). Regardless of the different maturities, the corresponding futures position of the underlying asset is booked upon exercising of the option.
11. With respect to options on the French Power Base Future, 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**

##### *Spot month position limit*

##### Deliverable supply

12. Deliverable supply amounts to 100,889,224 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) of France as displayed in the Statistical Factsheet for the year 2016 and the average import capacities of its neighbouring countries for 2017.
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 one calendar month for the spot month period.

##### Spot month position limit

15. The spot month limit has been set at 25,222,306 MWh, which represents 25% of the deliverable supply. The spot month limit applies to the French 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. 25,222,306 MWh, as required by Article 9(1) of RTS 21. There are only 2 market makers. Thus, the limit is to be set within a range of 5% - 50%.
17. BaFin has considered all potential factors, including the volatility in the contract as required by Article 21 of RTS 21, and none of them have been regarded as material or relevant to require an adjustment, either up or down, for the spot month limit.
18. As no adjustment was made to the baseline, this provides a spot position limit of 25,222,306 MWh, which represents 25% of the deliverable supply.

##### *Other months' position limit*

### Open interest

19. The open interest amounts to 543,266,600 MWh.
20. 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 April, May and June 2017. Option positions have been delta-adjusted.

### Other months' position limit

21. The other months' limit has been set at 119,518,652 MWh, which constitutes 22% of the reference amount. The other months' limit applies to the French Power Base Futures and Options. It includes monthly, quarterly and yearly contracts.

### Other months' position limit rationale

22. The baseline figure for the other months' limit amounts to 25% of open interest, i.e. 135,816,650 MWh, as required by Article 11(1) of RTS 21.
23. BaFin considered the following factors relevant for adjusting the baseline upwards:
  - Article 16(2) of RTS 21: there is a large number of separate expiries (six 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;
24. BaFin considered the following factors relevant for adjusting the baseline downwards:
  - Article 18(2) of RTS 21: the open interest is significantly higher than the deliverable supply (open interest is more than 5 times deliverable supply);
  - Article 20(2)(d) of RTS 21: power generation in France remains fairly concentrated. This factor needs to be taken into account as spot and futures market in power are closely intertwined. Measures to limit large speculative positions in the derivatives market can help to prevent these positions from negatively impacting competition in the underlying.
25. BaFin notes that, based on information on the number of cleared transactions, a great number of contracts are entered into OTC, i.e. the open interest does not adequately mirror the market size.
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, applying 22% as limit seems adequate as the open interest is higher than the deliverable supply and the competition in the market of the underlying is weak.

## V. ESMA's Assessment

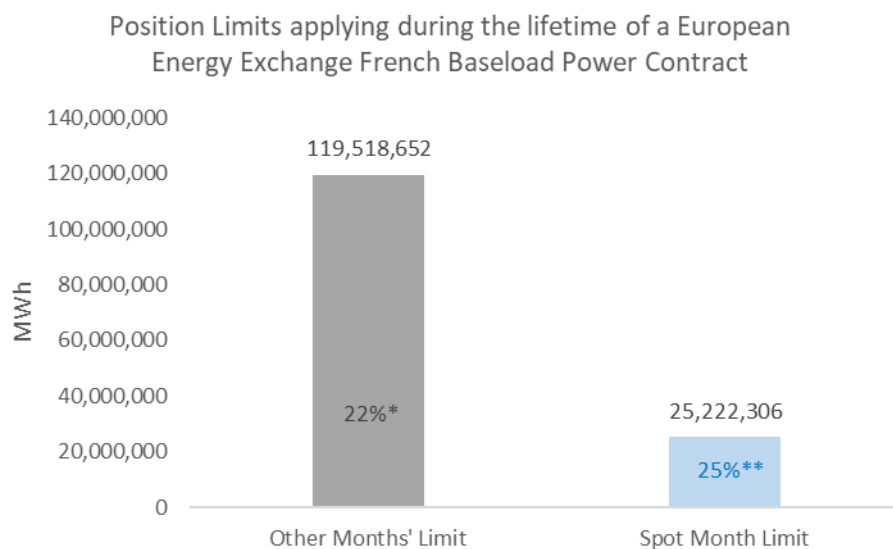
28. This Opinion concerns positions held in French Power Base contracts

29. ESMA has performed the assessment based on the information provided by 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 France for the year 2016 and the average import capacity in relation to neighbouring countries forecasted in 2017. 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. Based on the characteristics of the contract, ESMA considers it a reasonable approach not to have made any adjustments to the baseline.

#### Other months' position limit

37. 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.
38. Compared to the baseline figure of 25% of overall open interest, the other months' position limit has been adjusted downward and set at 22% of the open interest.
39. 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. ESMA also agrees that a downward adjustment is justified by the fact that the French Power market is a relatively closed market with a limited set of suppliers (which is consistent with Article 20(2)(d)).
40. 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*

41. 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.
42. 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 French Power Base contract are not hampered.



## **VI. Conclusion**

43. 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, 23 May 2019

Steven Maijoor

Chair

For the Board of Supervisors