European Securities and Markets Authority

Date: 11 March 2019
ESMA70-155-5629

OPINION on position limits on Powernext Italian PSV gas futures

I. Introduction and legal basis

1. On 13 March 2018, the European Securities and Markets Authority (ESMA) received a notification from Autorité des Marchés Financiers (AMF) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments[1] ("MiFID II") regarding the exact position limits AMF intends to set for PSV 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 (NERGY)

Commodity sub product: natural gas (NGAS)

Commodity further sub product: other (OTHR)

Name of trading venue: POWERNEXT DERIVATIVES

MIC: XPOW

Venue product code: PSV

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[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).

III.Market description

3. Natural gas is a hydrocarbon gas mixture consisting largely of methane and other hydrocarbons, occurring naturally underground (often in association with petroleum). It is used as a source of energy for heating, cooking, electricity generation, fuel for vehicles and chemical feedstock in the manufacture of plastics and other organic chemicals.

4. Natural gas is usually processed to remove impurities and meet the specifications of marketable natural gas. The resulting by-products include ethane, propane, butanes, pentanes, and higher molecular weight hydrocarbons, hydrogen sulphide, carbon dioxide, water vapour, and sometimes helium and nitrogen.

5. The fundamentals of the gas markets are based on the supply and demand of gas in Europe. On the supply side, the key drivers are the availability of gas production (especially those from Norway, the Netherlands, Russia and North Africa and Middle East), transportation and storage (pipelines maintenances or outages). On the demand side, the consumption is mainly driven by the weather (heating needs).

6. Market participants can be classified as:

    a. Utilities, which have a gas portfolio (entry/exit capacities, storages capacities, consumption clients, etc.) and use the market for optimizing or sourcing;

    b. Industrial consumers, which are essentially buyers in the wholesale market;

    c. Municipalities, which aggregate final consumers and bring their needs to the wholesale market;

    d. Operators (Transport system operators, storage system operators, LNG system operators, etc.) which enter the system for their own needs or for balancing purposes;

    e. Trading companies which does not have a shipper or supply agreement in the market (banks, commodities traders, investment firms, etc.)

7. Although congestions related to capacity limitation may appear (e.g. maintenances, upstream production problems), the gas system in Europe is designed to grant physical availability. As mentioned before, the Transmission System Operator is ultimately responsible for balancing supply and demand[4].

8. Powernext proposes Punto di Scambio Virtuale (PSV) derivative contracts for the 3 next months, the 3 next quarters, the 2 next seasons and the next calendar year. In 2017, 9 TTF

[4] The roles and the tools for balancing are defined in (EU) No 312/2014 of 26 March 2014 establishing a Network Code on Gas Balancing of Transmission networks.

derivatives instruments were proposed for trading in the PEGAS platform. In 2017, the volumes traded on the Powernext's PSV derivative contracts amounted to 27,2 TWh. All the contracts are physically delivered via a nomination to the relevant TSO.

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

9. Deliverable supply amounts to 304,235 lots. A lot is equivalent to 720 MWh.

10. The calculation of the deliverable supply is based on actual daily entry capacities for each of the entry types detailed below. While the capacities of the system are relatively stable during the year, the flows of gas depend on the consumption (not only national, but also European) which is influenced by the weather conditions. The components used for calculations of deliverable supply are described below:

1) Entry pipeline capacity = 3 523 GWh/d[5]

2) LNG import capacity = 543 GWh/d[6]

3) Storage withdrawal capacity = 3075 GWh/d[7]

4) Average indigenous production in 2017 = 161 GWh/d[8] (average 2016 in m^3, converted in GWh/day)

11. The total deliverable supply has been calculated as a sum of imports, LNG imports, storage withdrawal rate and production, obtaining a total deliverable supply per day of 7,302 GWh/d. The lot size used by the trading venue is 720 MWh (1MWh/h * 24h/day * 30 days/month =720 MWh/month). Therefore the deliverable supply has been converted in lots and equates to 304,235 lots.

Spot month position limit

12. Spot month limit amounts to 75,000 lots, which represents 24.65% of the deliverable supply.

Spot month position limit rationale

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[5] Source: https://www.entsog.eu/public/uploads/files/maps/systemdevelopment/ENTSOG-GIE_SYSDEV_MAP2016-2017.pdf
6 Source: https://www.entsog.eu/public/uploads/files/maps/systemdevelopment/ENTSOG-GIE_SYSDEV_MAP2016-2017.pdf
7 Source : Europe: http://www.gie.eu/index.php/maps-data/gse-storage-map
[8] http://ec.europa.eu/eurostat

13. When setting the spot month limit, the AMF has taken into account all the relevant factors described in RTS 21 and has not found any reason to apply adjustments to the spot month limit from the baseline.

14. In considering the volatility of the contract as per Article 21 of RTS 21, the AMF notices that there has been some variation in the price of the commodity derivative but has not found evidence that this is excessive or that lower position limits would reduce volatility.

15. Overall the spot month limit has been rounded down at the lower 1,000 lots, to 75,000 lots, which corresponds to 24.65 % of the deliverable supply.

Other months' position limit

Open interest

16. Open interest amounts to 20,674 lots. A lot is equivalent to 720 MWh. This open interest value was calculated as the average over one month (December 2017) of the daily open interest of futures based on data provided by Powernext/ECC (after cumulating the open interest of all futures i.e. maturities for every day)

Other months' position limit

17. The all other months' limit corresponds to 7 200 lots, which represents 34.8% of the open interest.

Other months' position limit rationale

18. When setting the other months' limit, the AMF has taken into account the relevant factors described in RTS 21 and has made the following adjustments:

19. Open interest (Art. 18 of RTS 21): The AMF notes that the open interest (20,674 lots, or 7 TWh in equivalent delivered energy) is not deemed to be large compared to other contracts traded in Europe (e.g. the OI on NBP contract listed on ICE reaches 265 555 lots or 2 770 TWh in equivalent delivered energy), hence does not adjust the limit under Article 18(1) of RTS 21.

20. On the other hand the AMF notices that the OI is significantly lower than the deliverable supply (12,645 vs 304,235). In the AMF view, the difference between open interest and deliverable supply justifies an upward adjustment under Article 18(3) of RTS 21. As this discrepancy is particularly significant, with a deliverable supply more than 21 times higher than the open interest, the other months limit has been adjusted to 35%. The other months limit has then been rounded down at the nearest 100 lots, which corresponds to 7 200 lots or 34.8% of the open interest.

21. The volatility in the contract (Article 21 of RTS 21): the AMF notices that there has been some variation in the price of the commodity derivative but has not found evidence that this is excessive or that lower position limits would reduce volatility.

22. Overall, the AMF considers that the levels chosen for the position limits constitute a good balance between the objectives of preventing market abuses, ensuring a well-functioning and orderly market without harming neither the development of commercial activities in the underlying commodity market nor the liquidity of its derivative market.

V. ESMA's Assessment

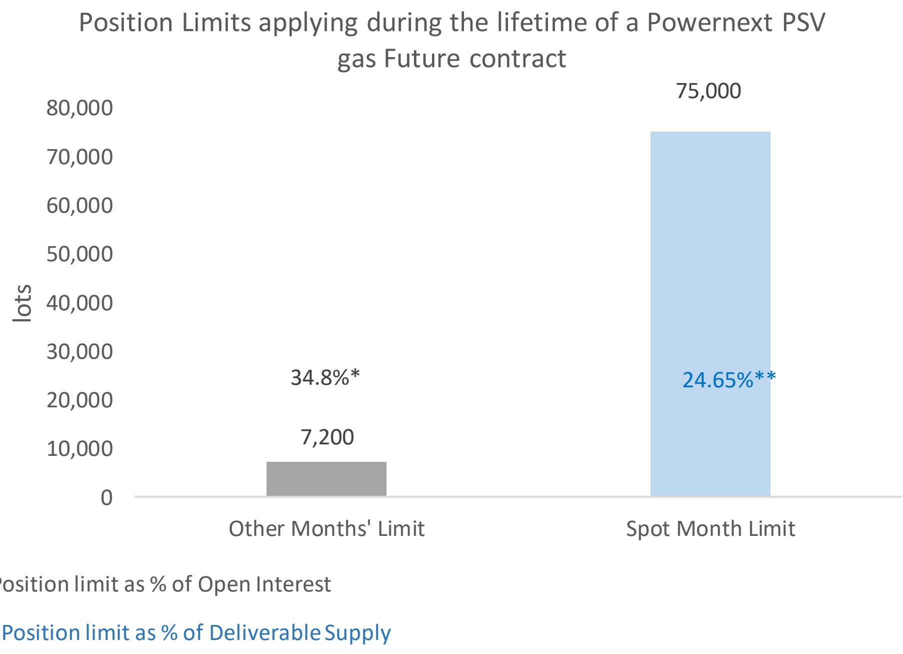
23. This Opinion concerns positions held in PSV Gas futures.

24. ESMA has performed the assessment based on the information provided by the AMF.

25. 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

26. The AMF has set one position limit for the whole spot month and one for the other months'.



Spot month position limit

27. The estimation of deliverable supply for natural gas is calculated by aggregating Italian gas local production, the imports and transmission capacity from neighbouring countries, LNG imports and the average withdrawal rate from storage facilities.

28. ESMA considers that the deliverable supply calculation's methodology 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".

29. Taking into account the potential adjustment factors, ESMA considers as reasonable to have set the spot month limit at the baseline, subject to rounding.

Other months' position limit

30. The open interest was calculated as the daily average over one month of the number of open contracts that have not been closed out or expired. ESMA considers such an approach suitable 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.

31. ESMA considers the upward adjustment to the other month limit made under Article 18 of RTS 21 as appropriate given that the open interest is significantly lower that the deliverable supply (open interest corresponds to 4.2% of deliverable supply).

32. ESMA agrees that the other months' limit set by the competent authority is appropriate.

33. 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

34. Under Article 57(1) of MiFID II, the objectives of the position limits are to prevent market abuse and support orderly pricing and settlement.

35. Based on the information provided by the competent authority ESMA notes that the spot month limit far exceeds the overall open interest in the PSV contract.

36. ESMA understands the need to avoid the risk of unduly constraining trading in this contract. However, there is a risk that the objectives set out in Article 57(1) of MiFID II may not be achieved where the spot month limit is well above the positions held by market participants.

37. In light of the assessment above, ESMA considers that the position limits set for the spot month and for 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 PSV contract are not hampered.

38. However, to help ensure that the objectives set out in Article 57(1) of MiFID II are met, ESMA considers that trading patterns in PSV contracts should be carefully monitored by the competent authority, in particular during the spot month, and that the limits should be re-viewed on a timely basis.

VI. Conclusion

39. 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, 11 March 2019

Steven Maijoor

Chair

For the Board of Supervisors