European Securities and Markets Authority

Date: 15 April 2019
ESMA70-155-6353

OPINION on position limits on Phelix DE Power Peak Futures contract

I. Introduction and legal basis

1. On 10 October 2018, the European Securities and Markets Authority (ESMA) received a notification from 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 BaFin intends to set for Phelix DE 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: DEP

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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.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. The Physical Electricity Index (Phelix) refers to the base load (Phelix Base) and peak load (Phelix Peak) price index published daily on the Power Spot Market for the German/Austrian market area. The Phelix is established by EPEX (European Power Exchange) SPOT and constitutes the underlying asset for the European Energy Exchange (EEX) Phelix Futures contract

4. The Phelix DE Power Peak Futures contracts are financially settled derivatives contracts referring to the average power spot market prices of future delivery periods of the German market area during peak time. Peak load contracts are solely composed of contracts for a delivery period of only 12 hours a day and only five days a week. Day, week, month, quarter and year contracts are available to trade. The furthest maturity to trade is six years. Gradually, the Phelix DE Power Peak Futures contracts are substituting the Phelix DE/AT Power Peak contracts. This shift of liquidity is due to the recent split of the bidding zones of Germany and Austria.

5. 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 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.

6. Since the electricity system constitutes a critical infrastructure, the German power market is 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.

7. 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. Former German market leaders RWE and E.ON have announced plans to break up Innogy, whose assets will be divided among parent RWE and rival E.ON. It is expected that this deal is going to strengthen RWE's production capacities and E.ON's grid business. However, as the deal has not been settled yet, it is not taken into account in this assessment.

8. 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.

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

9. Deliverable supply amounts to 56,217,480 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 as displayed on the ENTSO-E website for the year 2018 and the average yearly import capacities of Germany for 2018. Since ENTSO-E displays only figures for the zone DE-AT-LU, imports and NGC for Austria and Luxemburg were deducted. Figures for Austria and Luxemburg have been gathered from national energy regulators and ENTSO-E data on national basis.

11. 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 by multiplying them by the factor 3168 (264 business days x 12 hours) to calculate the deliverable supply for the entire year 2018. This number has been divided by 12 in order to align the deliverable supply to the time frame of one calendar month for the spot month period.

Spot month position limit

12. The spot month limit is set at 8,432,622 MWh, which represents 15% of the deliverable supply. The spot month limit applies to Phelix DE Power Peak Futures contracts. The spot month includes daily, weekly and monthly contracts.

Spot month position limit rationale

13. The baseline figure for the spot month was calculated as 25% of the estimated deliverable supply, i.e. 25% * 56,217,480 MWh = 14,054,370 MWh in accordance with Article 9(1) of RTS 21.

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

14. The deliverable supply is significantly larger than the open interest. BaFin considers that the rationale underpinning Article 18(3) with respect to the other months' requires a downward adjustment of the spot month limit. This should contribute to ensuring that no position holder is able to hold excessive shares of overall open interest as a consequence of the deliverable supply being substantially higher than the open interest.

15. 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.

16. Based on the above, BaFin has adjusted downwards the baseline figure by 10 percentage points and set the spot month limit at 8,432,622 MWh, which represents 15% of the deliverable supply.

Other months' position limit

Open interest

17. Open interest amounts to 15,405,370 MWh.

18. 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 April, May, June and July 2018. The open interest of Phelix DE is constantly rising. Since the introduction of the last set of position limits open interest has nearly doubled. This is due to the split of the price zone between Germany and Austria resulting in a shift of liquidity from Phelix DE/AT contracts to Phelix DE contracts. The most recent months are therefore considered the most meaningful.

Other months' position limit

19. The other months' limit is set at 4,621,611 MWh, which represents 30% of open interest.

Other months' position limit rationale

20. The open interest amounts to 15,405,370 MWh. The baseline figure for the other months limit amounts to 25% of open interest, i.e. 3,851,343 MWh.

21. BaFin made an upward adjustment under Article 16(2) of RTS 2 due to the large number of separate expiries (ten monthly, eleven quarterly and six yearly maturities). In contrast to daily and weekly contracts, quarterly and yearly contracts are traded in significant volumes;

22. As the overall open interest is significantly lower than the deliverable supply, BaFin made a further upward adjustment in accordance with Article 18(3) of RTS 21.

23. All the other potential adjustment factors set out in RTS 21 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.

24. Based on the above, BaFin has decided to make a total upward adjustment of 5 percentage points and to set the other months' limit at 30% of open interest. This provides a figure in lots of 4,621,611 MWh.

V. ESMA's Assessment

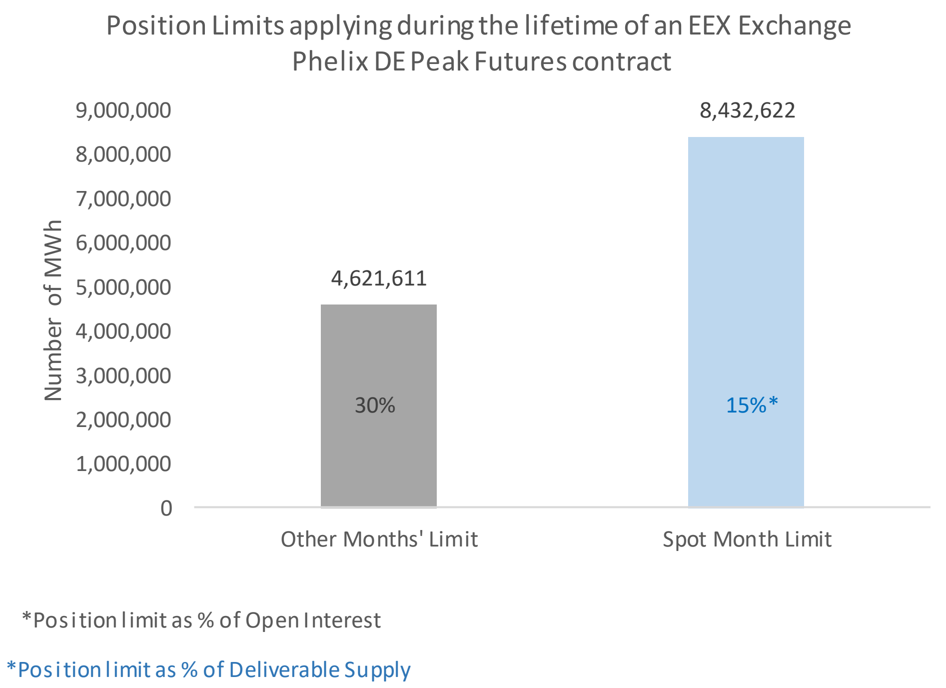
25. This Opinion concerns positions held in Phelix DE Power Peak Futures contracts.

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

27. 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

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



Spot month position limit

29. The calculation of the deliverable supply is based on ENTSO-e figures for 2017. As ENTSO-e figures for the German market also includes Austria and Luxembourg, ESMA considers appropriate to have deducted imports and NGC of Austria and Luxemburg based on data provided by national regulators. ESMA agrees with the methodology used to include both domestic generation plus imports into Germany.

30. While physical delivery of power depends on the actual days of the month, ESMA also agrees with using standard 22 days (average calendar days in a month) and 12h per day to calculate monthly deliverable supply, in order to standardize the monthly deliverable supply of power for these peak load contracts. 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”.

31. ESMA agrees that the rationale underpinning Article 18(3) with respect to the other months’ enables the national competent authority to adjust the spot month limit downwards in case the deliverable supply is significantly higher than the open interest. ESMA therefore considers that a downward adjustment of the spot month limit for the Phelix DE Power Peak Future contracts is reasonable under Article 18(3) given the very large difference between deliverable supply and open interest.

Other months’ position limit

32. The open interest was calculated as the average size of daily open interest throughout April, May, June and July 2018 after aggregating all contracts across all maturities and converting them to MWh. ESMA considers such an approach sensible in this case as open interest is steadily increasing due to the split of the German-Austrian price zone and considers such approach consistent with Article 12 of RTS 21.

33. ESMA considers it is reasonable approach to have adjusted the other months’ limit upwards under Article 16(2) of RTS 21 due to the large number of separate expiries.

34. ESMA agrees that a downward adjustment of the position limit from the baseline is justified under Article 18 (3) of RTS 21 as the open interest is significantly lower than the deliverable supply.

35. Overall, these position limits have been set following the methodology established by RTS 21.

Compatibility with the objectives of Article 57(1) of MiFID II

36. 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.

37. 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 2017.

38. ESMA understands the need to avoid the risk of unduly constraining trading in this increasingly liquid commodity derivative market where underlying market participants 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

39. 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 Phelix DE Power Peak Futures contracts are not hampered

40. 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 Phelix DE Power Peak Futures contracts 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

41. 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