

OPINION on position limits on Powernext PEG natural gas contracts

I. Introduction and legal basis

1. On 17 November 2017 the European Securities and Markets Authority (ESMA) received a notification from the Autorité des Marchés Financiers (AMF) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments¹ ("MiFID II") regarding the exact position limits the AMF has set for Point d'échange de gaz (PEG) futures 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 derivatives² ("RTS 21") and taking into account the factors referred to in Article 57(3) of MiFID II. Additional information was provided on 28 November 2018.
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: natural gas (NGAS)

Commodity further sub product: other (OTHR)

Name of trading venue: POWERNEXT DERIVATIVES

MIC: XPOW

Venue product code: PEG

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, 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 in this market can be classified as:
 - a. Utilities, which have a gas portfolio (entry/exit capacities, storage 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 do 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 (TSO) is ultimately responsible for balancing supply and demand⁴.
8. Point d'échange de gaz (PEG) represents a market area located in France. It is a virtual trading hub which balances buyers and sellers of natural gas.

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.

9. Powernext offers PEG derivative contracts for the next 4 months, the next 4 quarters, the next 4 seasons and the next 2 calendar years. In 2017, 14 PEG derivatives instruments were offered for trading on Powernext. No options are offered on this contract.
10. In 2016, the volumes traded on the Powernext's PEG derivative contracts amounted to 20 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 calculation methodology

11. Deliverable supply amounts to 5,753,000 lots. A lot is equivalent to 30 MWh.
12. The lot size of the PEG contract is significantly lower than standard lot size of other gas derivatives in Europe (30 MWh vs 720 MWh) which is due to the hub specific balancing agreement of hourly balancing rather than daily.
13. The calculation of the deliverable supply is based on actual daily entry capacities of each of the source type described below to the French PEG trading hub. While the capacities of the system are relatively stable during the year, the flows of gas depend on the consumption, which depends on the weather conditions. This calculation takes into account the following sources:
 - 1) Entry pipeline capacity = 2,242 GWh/d⁵
 - 2) LNG import capacity = 1,030 GWh/d⁶
 - 3) Storage withdrawal capacity = 2,480 GWh/d⁷
 - 4) Average indigenous production in 2016 = 1 GWh/d⁸
14. The total deliverable supply sums up to 5,753 GWh/d. The lot size used by the trading venue is 30 MWh (1 MWh/day * 30 days/month = 30 MWh/month). Therefore, the final monthly deliverable supply in lots equates to 5,753,000 lots (5,753*1000 x 30 / 30).

Spot month position limit

15. Spot month limit amounts to 1,500,000 lots, which corresponds to 26.1 % of the deliverable supply.

⁵ Entso-g: https://www.entso-g.eu/sites/default/files/2018-10/ENTSOG-GIE_SYSDEV_MAP2015-2016.pdf

⁶ Ibidem

⁷ Gas Infrastructure Europe (GIE) : <https://agsi.gie.eu/#/historical/DE>

⁸ International Energy Agency: <https://www.iea.org/media/statistics/surveys/gas/Natgas.pdf> (p.8), http://wds.iea.org/wds/pdf/Gas_documentation.pdf (p. 45, 47)



Spot month position limit rationale

16. The AMF has considered all the adjustment factors available in RTS 21, however the AMF does not see any of those factors as appropriate to justify an adjustment either upwards or downwards from the baseline. The spot month limit has been rounded up to 1,500,000 lots, which corresponds to 26.1% of the deliverable supply.
17. 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 the AMF has not found evidence that this is excessive or that lower position limit would reduce volatility.

Other months' position limit

Open interest calculation methodology

18. The open interest amounts to 395,838 lots. A lot is equivalent to 30 MWh.
19. The open interest value was calculated as the average of the daily open interest of all PEG futures from the 1 January 2017 to 31 December 2017.
20. It was based on data provided by the European Commodity Clearing (ECC) i.e. the CCP of Powernext. The netting of calculation was performed on CCP member's level.

Other months' position limit

21. Other months limit amounts to 138,000 lots, which corresponds to 34.9% of the open interest.

Other months' position limit rationale

22. The AMF took into account the discrepancy between the small open interest and the large deliverable supply to adjust the other months limit upwards, under Article 18(3). Indeed, this discrepancy is significant, with a deliverable supply amounting to more than 14 times the open interest in 2017.
23. 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 the AMF has not found evidence that this is excessive or that lower position limit would reduce volatility.
24. A total upward adjustment of 10 percentage points was made resulting in an adjusted other months position limit of 35%. This provides a figure of 138,543 lots which has been rounded down to 138,000 lots. This equates to a final limit as a percentage of open interest of 34.9%.
25. 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

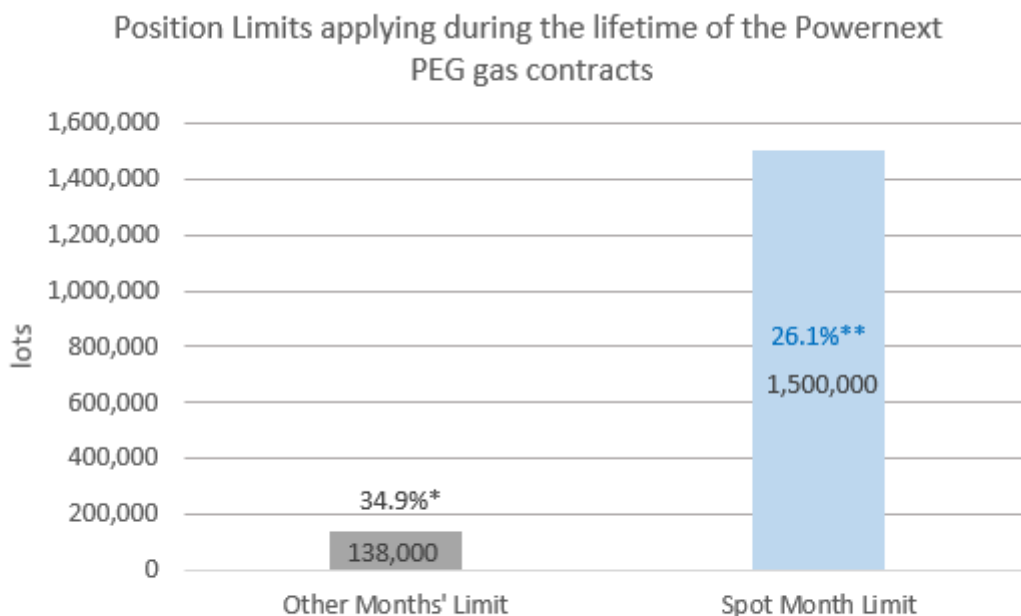
orderly market without harming neither the development of commercial activities in the underlying commodity market nor the liquidity of its derivative market.

V. ESMA's Assessment

- 26. This Opinion concerns positions held in natural gas PEG futures contracts.
- 27. ESMA has performed the assessment based on the information provided by the AMF.
- 28. 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

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



* Position limit as % of Open Interest

** Position limit as % of Deliverable Supply

Spot month position limit

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

31. 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".
32. 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

33. The open interest was calculated as the daily average over 2017 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.
34. Compared to the baseline figure of 25% of overall open interest, the other months' position limit has been adjusted upward and set at 34.9% of the open interest.
35. The other months' position limit has been adjusted upwards to take into consideration the fact that the open interest is significantly lower than the deliverable supply. This is consistent with Article 18(3) of RTS 21.
36. 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

37. Under Article 57(1) of MiFID II, the objectives of the position limits are to prevent market abuse and support orderly pricing and settlement.
38. Based on the information provided by the competent authority ESMA notes that the spot month limit far exceeds the overall open interest in the PEG natural gas contracts.
39. ESMA understands the need to avoid the risk of unduly constraining 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.
40. 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 natural gas market and the liquidity of PEG contracts are not hampered.
41. However, to help ensure that the objectives set out in Article 57(1) of MiFID II are met, ESMA considers that trading patterns in PEG contracts should be carefully monitored by the



competent authority, in particular during the spot month, and that the limits should be reviewed on a timely basis.

VI. Conclusion

42. 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 Maijor

Chair

For the Board of Supervisors