

OPINION on position limits on Nasdaq Oslo Nordic Power contracts, including EPADs

I. Introduction and legal basis

1. On 22 December 2017 the European Securities and Markets Authority (ESMA) received a notification from the Norwegian Finanstilsynet (“Finanstilsynet”) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments¹ (“MiFID II”) regarding the exact position limits Finanstilsynet intends to set for Nordic Power futures and options commodity contracts, including Nordic Electricity Price Area Differential (EPAD) 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. MiFIR entered into force in Norway on 3 December 2019. Additional information was received on 29 June 2020.
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: Base load (BSLD)

Name of trading venue: NASDAQ OSLO ASA

MIC: NORX

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).



Principal Venue product code: ENO⁴

III. Market description

3. The Nordic electricity market (Norway, Sweden, Denmark and Finland) consists of 12 different bidding zones. The Nordic system price published by European Market Coupling Operator AS is the central reference price in the Nordic electricity market. It is calculated on an hourly basis based on all bids and offers posted in Nordic bidding zones (+/- any import or export to neighbouring areas) in the Day Ahead-market coupling. The system price represents the single price that would emerge in the entire Nordic area if there were no physical congestions in the grid. The Nordic system price can be interpreted as a price for a virtual Nordic price area, but it is not a price for a physical point of delivery. Physical deliveries are settled against the price for the specific bidding zones.
4. The Nordic Power (including Nordic EPADs) derivative contract is cash settled based on prices published by European Market Coupling Operator AS⁵.
5. In addition to the Nordic system price contract, the trading venue is trading Nordic EPAD-contracts (Electricity Price Area Differentials). The EPAD is a spread contract between one bidding zone price and the Nordic system price and is not in itself a bidding zone hedge instrument. These contracts allow market participants to utilize the liquidity of the Nordic system price contracts for hedging, however as congestion between different bidding zones can result in different bidding zone prices, both the EPADs and the Nordic system price contracts combined are necessary to achieve a full bidding zone hedge. The EPADs constitutes a tool to fulfil hedging needs taking into account the differences between the bidding zone price and the Nordic system price.
6. The EPAD-contracts are spread contracts as the value is determined based on differences in price between one bidding zone price and the Nordic system price, however the EPAD-contracts are not spread contracts between two different commodities as known from other commodity markets. It's the same power that forms the basis for both the Nordic system price and the area/bidding zone price as the calculation of the Nordic system price is based on all bids and offers posted in Nordic bidding zones. As an example, EPAD Helsinki constitutes of area price Helsinki minus the Nordic system price, where the Nordic system price also include the Helsinki area price.
7. The price difference between price areas/bidding zones and the Nordic system price for the commodity is constrained (influencing volume and price) by the physical capacity on interconnectors. This price difference is the underlying price for the EPAD contracts.

⁴ This is the principal venue product code (ENO) for this contract. However, the position limits set will apply to other associated venue product codes (VPCs) as well. For a complete and updated list of VPCs to which the same limit applies, please check the NFS website at <https://www.finanstilsynet.no/tema/mifid-ii--mifir/varederivater-i-mifidii-forskriften/>

⁵ <https://www.nordpoolgroup.com/>

8. The availability of Nordic Power is limited by the physical output of power production units in the Nordic region and the maximum inflow of electricity at any given time. Power must be consumed immediately, i.e. it is perishable. The commodity cannot be stored, and hence suppliers and consumers lack inventories. Therefore, the dynamics of electricity derivatives prices may behave differently than other commodity derivatives, where the underlying commodity can be stored.
9. The power market is highly influenced by macroeconomic factors, e.g. power prices are expected to rise, ceteris paribus, as a function of economic growth. Other key influencing factors are weather conditions like precipitation and wind conditions.
10. The market participants are typically power producers, suppliers and traders. Large end-users also trade on the physical market. In the Nordic electricity market model, there is a strong interlink between the financial and the physical market (e.g. Nasdaq and Nord Pool) where the number of common market participants is high on both venues. Exchange traded cash settled derivatives are an essential part of the electricity producers and consumers financial risk management. They usually hedge the long-term power production and consumption several years in advance due to the large price variation in the physical market.

IV. Proposed limit and rationale

11. Due to the Nordic market structure, it is Finanstilsynet's opinion that the Nordic EPAD contracts and the Nordic system price contract should not be seen as separate contracts for the purpose of position limits. Therefore, the position limits apply to both the EPAD-contracts and the Nordic system price contract.

Spot month position limit

Deliverable supply

12. Deliverable supply amounts to 77,232,723 MWh. A lot is equivalent to 1 MW
13. The sum of the deliverable supply in the bidding zones constitutes the deliverable supply for the Nordic system price. The ENTSO-E (European Network of Transmission System Operators for Electricity) has been used as a data source when calculating the deliverable supply. The deliverable supply is calculated based on the yearly installed generating capacity in the Nordic area (100,715 MW) and average yearly forecasted transmission capacity (import) to the Nordic area (5,083 MW) for 2017. The data displayed on the ENTSO-E website has been converted from MW to MWh by using 8760 hours as a reference. The yearly deliverable supply is divided by 12 in order to align the deliverable supply used to set the spot month limit with the spot month period (1 calendar month).



Spot month position limit

14. The spot month limit is set at 19,308,181 MWh, which represents 25% of deliverable supply.

Spot month position limit rationale

15. As the daily average open interest in 2016 is above 20,000 lots, the Nordic Power Base Load contract is classified as a 'liquid' contract with a baseline limit of 25% and a standard range of the limit between 5%-50% as required by Article 19(2)(b) of RTS 21 as the number of investment firms acting as a market maker in accordance with Article 4(1)(7) of Directive 2014/65/EU in the commodity derivative at the time the position limit is set or reviewed is lower than three.
16. 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 Finanstilsynet has not found evidence that this is excessive or that lower position limits would reduce volatility.
17. All other adjustment factors have been considered by Finanstilsynet and are not regarded as material or relevant to require adjustments, either up or down, from the baseline.
18. Therefore, Finanstilsynet has decided not to change the position limit from the 25% baseline. This results in a spot month limit of 19,308,181 MWh.

Other months' position limit

Open interest

19. Open interest amounts to 270,441,320 MWh. At the time of submission, the Nordic Power (inc. Nordic EPADs) contract can be traded on two trading venues, Nasdaq Stockholm AB and Nasdaq Oslo ASA, both clearing at the same Nasdaq clearing venue in Sweden. The orders from the different trading venues are always combined in a joint order book and form the same pool of open interest with the Clearinghouse. Members entering into trades can have counterparties from either exchange. The primary trading venue for the Nordic power market is Nasdaq Oslo ASA, which holds over 90 % of all open interest whilst the remainder is held by members with Nasdaq Stockholm AB.
20. When setting position limit, Finanstilsynet has taken the open interest for the combined markets in Sweden and Norway in consideration.
21. Total open interest figure has been calculated from data supplied by Nasdaq Stockholm AB and Nasdaq Oslo ASA and is the daily average of the absolute amount of open long or short futures and delta-adjusted option positions which have not been closed out or expired. The reference period used is the period from July 2016 to June 2017.



22. On 1 April 2019, trading in Nordic Power (including EPADs) contract was terminated on Nasdaq Stockholm AB and part of the open interest was transferred to Nasdaq Oslo ASA. On 29 June 2020, Finanstilsynet confirmed that the termination of trading on Nasdaq Stockholm AB did not result in a significant change of the open interest in the Nordic Power (including EPADs) contract.

Other months' position limit rationale

23. The other months limit amounts to 67,610,330 MWh.

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

25. 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 Finanstilsynet has not found evidence that this is excessive or that lower position limits would reduce volatility.

26. All other factors of RTS 21 were taken into consideration and none was regarded relevant by Finanstilsynet at the time of the notification to move the limit upwards or downwards. Finanstilsynet has therefore decided to keep the other months' limit at 25% of the open interest, which results in an other months' limit of 67, 610,330 MWh.

V. ESMA's Assessment

27. This Opinion concerns positions held in Nordic Power futures and options (including Nordic EPADs).

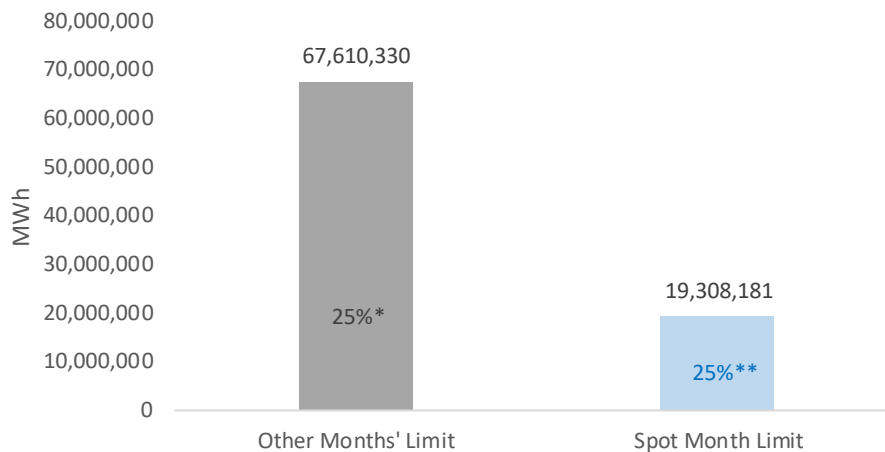
28. ESMA has performed the assessment based on the information provided by Finanstilsynet.

29. 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

30. Finanstilsynet has set a position limit for the whole spot month and another position limit for other months.

Position Limits applying during the lifetime of a Nasdaq Oslo Nordic Power contract



*Position limit as % of Open Interest

**Position limit as % of Deliverable Supply

Spot month position limit

31. The calculation of the deliverable supply is based on ENTSO-e figures for 2017.
32. ESMA agrees with the methodology used for the calculation of the deliverable supply which include both the Net Generating Capacity in the Nordic area and the average import capacities to the Nordic area from neighbouring countries. ESMA also agrees with the methodology for converting the ENTSO-e figures into MWh per month. 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.
33. Considering the characteristics of the contract, ESMA is of the view that it is a reasonable approach not to have adjusted the baseline upwards or downwards.

Other months' position limits

34. The open interest has been calculated as the daily average of the absolute amount of open long or short futures and delta-adjusted option positions which have not been closed out or expired for the period running from July 2016 to June 2017. Based on the information provided by Finanstilsynet that the termination of trading of the Nordic Power contract on Nasdaq Stockholm AB in April 2019 did not lead to a significant change in the open interest, ESMA considers that the reference period is consistent with Article 12 of RTS 21.



35. Considering the characteristics of the contract, ESMA is of the view that it is a reasonable approach not to have adjusted the baseline limit upwards or downwards at the time of the notification.
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. 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) MiFID II.
38. Overall, the position limits 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 an orderly market and orderly settlement, while ensuring that the development of commercial activities in the underlying market and the liquidity of the Nordic Power contract are not hampered.

VI. Conclusion

39. . Based on 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, 2 September 2020

Steven Maijoor

Chair

For the Board of Supervisors