

## **OPINION on position limits on PXE Czech Financial Baseload Futures contracts**

### **I. Introduction and legal basis**

1. On 24 January 2018, 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 the BaFin intends to set for the PXE Czech Financial Baseload Future 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<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: baseload (BSLD)

Name of trading venue: EUROPEAN ENERGY EXCHANGE

MIC: XEEE

Venue product code: FXB

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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, p. 84).

### III. Market description by the competent authority

3. The PXE Czech Financial Baseload Futures contract is a cash-settled derivative contract referring to the average power spot market price of future delivery periods of the Czech market area. Formerly, the contract was traded at Power Exchange Central Europe (PXE). In the course of EEX's acquisition of PXE the contract has been migrated from PXE to EEX. The contracts are traded in lots for which one lot equals 1 MW. Days, weekends, weeks, months, quarters and years are listed in parallel.
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 very 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 a report<sup>4</sup> on Czechia, the Czech electricity markets is still highly concentrated. It is characterised by the dominant position of České Energetické Závody (CEZ), which is the country's main electricity generation company. CEZ produces about 75% of domestic demand. The CEZ group is also active in other Eastern European power markets, making it one of the ten biggest European energy companies. CEZ is substantially owned by the Czech Government, with around 70% shares in government hands. In 2011, the European Commission started an investigation whether CEZ had abused its dominant position in the Czech power market by excluding existing or potential competitors from the market. In 2012, the proceeding was stopped when CEZ committed itself to sell one of its power plants. However, CEZ still owns most of Czechia's power plants that make up 79% of domestic Net Generating Capacity (NGC).
6. Czechia's energy distribution company CEPS is also under government control. The Czech electrical grid is synchronised with the rest of continental Europe. Cross-border interconnections exist with all neighbouring countries, i.e. Germany, Poland, Slovakia and Austria.

### IV. Proposed limit and rationale

*Spot month position limit*

Deliverable supply

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<sup>4</sup> [http://ec.europa.eu/competition/elojade/isef/case\\_details.cfm?proc\\_code=1\\_39727](http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_39727)

7. Deliverable supply amounts to 17,231,407 MWh.
8. 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 NGC of Czechia as displayed in the Statistical Factsheet of ENTSO-E for the year 2016<sup>5</sup> (20,188 MW) and its average yearly import capacities in relation to neighbouring countries as displayed on the ENTSO-e transparency website for transfer capacities in 2017<sup>6</sup> (3,417 MW). The NGC data of ENTSO-e for the year 2017 was not taken into account as the data for the Czechia was not available yet.
9. These values of ENTSO-e have been converted from yearly MW to MWh per year. The overall value was then divided by the factor of 12 to align the deliverable supply to the time frame of one calendar month for the spot month period.

#### Spot month limit

10. The spot limit has been set at 3,446,281 MWh, which represents 20% of the deliverable supply. It includes daily contracts, weekend contracts, week contracts, and monthly contract.

#### Spot month position limit rationale

11. Since the PXE Czech Financial Baseload Futures contract is not a food contract, its baseline figure for the spot month, which is based on deliverable supply, was calculated as 25% of the estimated deliverable supply, i.e.  $25\% * 17,231,407 \text{ MWh} = 4,307,852 \text{ MWh}$ .
12. BaFin considered the following factor for adjusting the limit downwards:
  - Article 20(2)(d) of RTS 21: In Czechia, CEZ dominates a large part of the underlying power spot market. Therefore, measures to limit large speculative positions in the derivatives market can help to prevent these positions from negatively impacting competition in the underlying.
13. 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 BaFin has not found evidence that this is excessive or that lower position limits would reduce volatility.
14. All the other potential adjustment factors set out in RTS 21 have been considered by BaFin and were not regarded as material or relevant to require additional adjustments, either up or down, from the baseline.

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<sup>5</sup> <https://www.entsoe.eu/data/power-stats/net-gen-capacity/>

<sup>6</sup> [https://transparency.entsoe.eu/transmission-domain/ntcYear/show?name=&defaultValue=false&viewType=TABLE&areaType=BORDER\\_BZN&atch=false&dateTime.dateTime=01.01.2017+00:00|UTC|YEAR&border.values=CTY|10YCZ-CEPS-----N|BZN\\_BZN|10YCZ-CEPS-----N\\_BZN\\_BZN|10YSK-SEPS-----K&direction.values=Export&direction.values=Import](https://transparency.entsoe.eu/transmission-domain/ntcYear/show?name=&defaultValue=false&viewType=TABLE&areaType=BORDER_BZN&atch=false&dateTime.dateTime=01.01.2017+00:00|UTC|YEAR&border.values=CTY|10YCZ-CEPS-----N|BZN_BZN|10YCZ-CEPS-----N_BZN_BZN|10YSK-SEPS-----K&direction.values=Export&direction.values=Import)



15. In sum, applying 20% as the limit seems adequate.

#### *Other months' position limit*

##### Open interest

16. Open interest amounts to 18,985,662 MWh. 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 (September, October, November 2017).

##### Other months' limit

17. The other months' limit has been set at 4,176,845 MWh, which represents 22% of open interest. It includes monthly (other than spot month), quarterly and yearly contracts.

##### Other months' position limit rationale

18. BaFin considered the following factor for adjusting the limit downwards:

- Article 20(2)(d) of RTS 21: In Czechia, CEZ dominates a large part of the underlying power spot market. Therefore, measures to limit large speculative positions in the derivatives market can help to prevent these positions from negatively impacting competition in the underlying.

19. 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.

20. All the other potential adjustment factors set out in RTS 21 have been considered by BaFin and were not regarded as material or relevant to require additional adjustments, either up or down, from the baseline.

21. In sum, applying 22% as the limit seems adequate.

## **V. ESMA's Assessment**

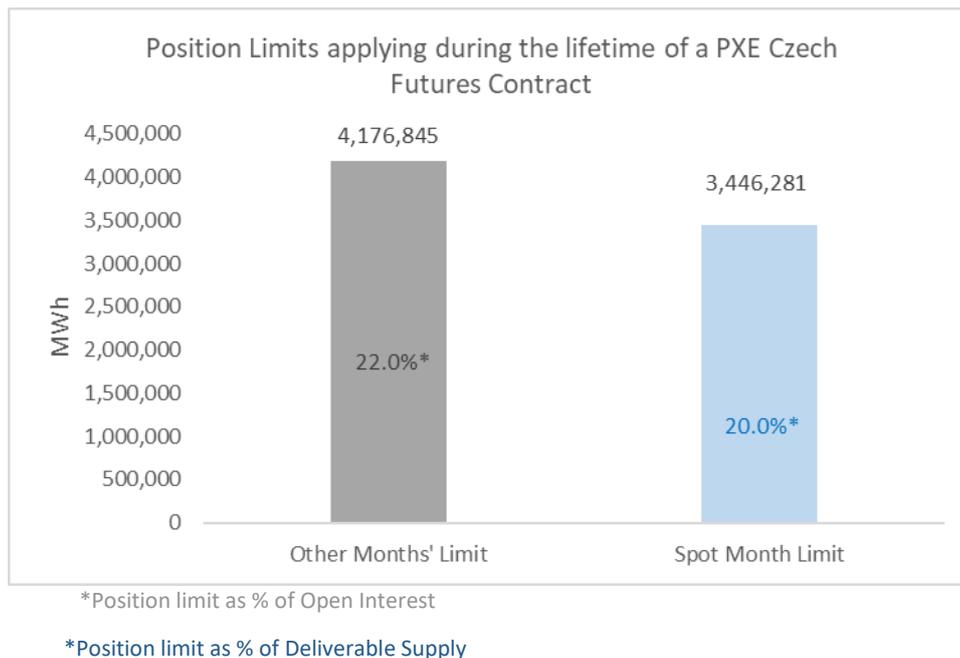
22. This Opinion concerns positions held in PXE Czech Financial Baseload Futures contracts.

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

24. 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*

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



### Spot month position limit

26. The calculation of the deliverable supply is based on ENTSO-e figures for 2017. ESMA agrees with using data from ENTSO-e to calculate deliverable supply, as this ensures publicly available figures consistent at the European level. ESMA also considers appropriate to including both domestic generation and imports into Czechia based on the capacity of the interconnectors of Czechia to neighbouring countries, as this energy would also be available for delivery.

27. 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”.

28. The monthly deliverable supply figure has been calculated by converting the capacity (expressed in MW) to MWh per month. Given the characteristics of the contract (i.e. delivery of electricity 24 hours per day during every day of the delivery period), this conversion is performed as follows: monthly deliverable supply (in MWh) = total capacity (in MW) x 24 hours x 365 days / 12 months.



29. ESMA agrees with the downward adjustment made by BaFin to the spot month limit under Article 20 of RTS 21 because of the dominant position of CZE in Czechia and the need to have measures to limit large speculative positions in the derivatives market.

#### Other months' position limit

30. The open interest 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. 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.

31. ESMA considers that the adjustment made under Article 20 of RTS 21 is appropriate because of the dominant position of CZE in Czechia and the need to have measures to limit large speculative positions in the derivatives market.

32. 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*

33. 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.

34. Overall, the position limits set for the spot month and 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 PXE Czech Financial Baseload Futures contract are not hampered.



## **VI. Conclusion**

35. Based on all the considerations and analysis presented above, it is ESMA's opinion that this 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. This 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