OPINION on position limits on Phelix DE/AT OTF Baseload Futures contracts

I. Introduction and legal basis

1. On 5 April 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[1] ("MiFID II") regarding the exact position limits BaFin intends to set for Phelix DE/AT OTF Baseload 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: base load (BSLD)

Name of trading venue(s): OTF EEX

MIC: XEEO

Venue product code: N1B

[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. The Phelix DE/AT OTF Baseload Futures contracts, offered at the OTF of EEX, are financially settled derivatives contracts referring to the average power spot market prices of future delivery periods of the German/Austrian market area. It is planned to substitute these contract types in the longer term with separate contracts for the German market area and for the Austrian market area. The OTF offers trading in monthly, quarterly and yearly Phelix DE/AT Baseload Futures contracts.

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. 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.

5. Since the electricity system constitutes critical infrastructure, power markets in Germany and Austria are 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.

6. 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. The market is thus becoming increasingly diverse, a trend that is further demonstrated by the recent decision of former German market leaders RWE and E.ON to split their businesses to focus on conventional energy business on the one hand and the renewable business on the other hand.

7. Recently, 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

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

Deliverable supply

8. Deliverable supply amounts to 170,371,780 MWh.

9. 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 and Austria as displayed on the Website of ENTSO-E for the year 2017 and the average yearly import capacities of these countries for 2017. These values of ENTSO-E have been converted from MW to MWh per year. The overall value was then divided by the factor of 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

10. The spot month limit amounts to 34,074,356 MWh, which is equivalent to 20% of deliverable supply. The spot month (calendar month) includes monthly contracts.

Spot month position limit rationale

11. Since the underlying of Phelix DE/AT OTF Baseload Futures contract is not food intended for human consumption, the baseline for the spot month has been set at 25% of deliverable supply, i.e. 42,592, 945 MWh, as required by Article 9(1) of RTS 21.

12. BaFin considered relevant to adjust the spot month limit downwards in accordance with Article 18(3) of RTS 21 as the deliverable supply is significantly higher than the open interest (327%).

13. All other factors have been considered and are not regarded by BaFin 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.

14. Based on the above, BaFin has set the spot month limit at 20% of deliverable supply. This results in a spot month limit of 34,074,356 MWh.

Other month position limit

Open interest

15. The open interest amounts to 52,020,521 MWh.

16. 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 (October, November, December 2017).

Other month's limit

17. The other months' limit amounts to 15,606,156 MWh, which represents 30% of open interest.

Other month's limit rationale

18. The baseline for the other months has been set at 25% of open interest as required by Article 11(1) of RTS 21.

19. BaFin made an upward adjustment in accordance with Article 18(3) of RTS 21 as the overall open interest is significantly lower than the deliverable supply (327%).

20. All other factors have been considered and are not regarded by BaFin 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.

21. Based on the above, BaFin has considered that applying a 30% other months' limit was adequate. This results in another months' limit of 15,606,156 MWh.

V. ESMA's Assessment

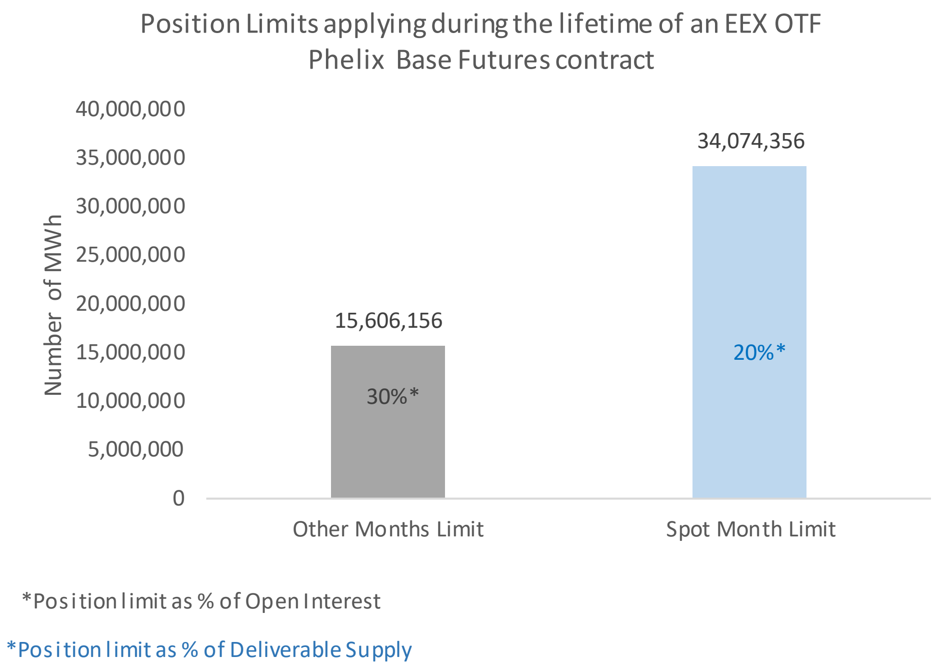
22. This Opinion concerns positions held in Phelix DE/AT OTF Baseload Futures contracts.

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 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.

27. ESMA also agrees with the methodology used to include both domestic generation plus imports into Austria and Germany and to convert ENTSO-E MW figure in monthly MWh. 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. ESMA considers that, since the deliverable supply is significantly higher than the open interest (327%), a downward adjustment to the spot month limit could reasonably be made under Article 18(3) of RTS 21. ESMA is of the view 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 open interest is significantly lower than the deliverable supply.

Other months' position limit

29. The open interest was calculated as the average of daily open interest for three last three months in 2017 and aggregating all contracts across all maturities and converting them to MWh. ESMA considers such an approach sensible in this case as it allows better taking into

account the declining trend in open interest in the contract. ESMA also considers such approach consistent with Article 12 of RTS 21.

30. ESMA agrees that an upward adjustment of the position limit from the baseline is justified for the other months' limit in accordance with Article 18(3) of RTS 21 given that the open interest is significantly lower than the deliverable supply.

31. 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

32. 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.

33. Based on the information provided by the competent authority, ESMA notes that the open interest in the Phelix DE/AT OTF Baseload Futures contracts has continue to decrease since the position limits were set. 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 other months' is well above the positions held by market participants.

34. 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 Phelix DE/AT OTF Baseload Futures contracts are not hampered

35. 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 the Phelix DE/AT OTF Baseload Futures contracts should be carefully monitored by the competent authority, in particular during the other month's, and that the limits should be reviewed on a timely basis.

VI. Conclusion

36. 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