

OPINION on position limits on EEX Italian Power Peak contracts

I. Introduction and legal basis

1. On 5 June 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 instruments¹ (“MiFID II”) regarding the exact position limits that BaFin intends to set for EEX Italian Power Peak 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.
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: FDP

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 EEX Italian Power Peak Future is a derivative contract referring to the average power spot market price of future delivery periods of the Italian market area. The contract is cash-settled.
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 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 and air-conditioning demand in summer, electricity generation tends to be higher in those seasons. However, such seasonal effects are small.
5. The Italian electricity market is well connected with the grids of its neighbouring countries, including non-EU countries in Northern Africa.
6. Italy's power generation capacity stems from various sources of which renewable energy becomes increasingly important. In 2015 its electricity production mix was comprised of 15% coal, 39% natural gas, 7% oil and 39% renewables. To meet the EU renewable energy targets, Italian electricity regulations give priority to energy produced by renewable energy sources. The Electricity and Gas Authority (ARERA) is the independent body that regulates, controls and monitors the electricity market in Italy. The sole operator of the national power transmission system is Terna that operates around 98% of the Italian high-voltage power transmission grid. The most important shareholder is the Italian State via Cassa Depositi e Prestiti.
7. Power generation is mainly in the hands of several major entities, e.g. Enel, the former state monopolist, Eni and Edison. The biggest six operators produce nearly 50% of the Italian power generation.
8. The underlying of the EEX Italian Power Peak contract is the delivery or acceptance of delivery of Italian electricity with a constant output of 1 MW during the delivery time (08:00 until 20:00) for all days Monday through Friday during the delivery period. The possible delivery periods for this contract are: day, week, month, quarter and year.
9. With respect to EEX Italian Power Peak futures contracts, at maximum, the following maturities can be traded: for "Day Futures" the respective next 34 days; for "Week Futures" the current and the next 4 weeks; for "Month Futures" the current and the next 6 months; for "Quarter Futures" the respective next 7 full quarters; and for "Year Futures" the respective next 6 full years.

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

10. Deliverable supply amounts to 35,601,456 MWh.
11. 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)⁴ of Italy as displayed in the Statistical Factsheet of ENTSO-E for the year 2016 and the average import capacities in relation to neighbouring countries as displayed on the ENTSO-E transparency website for forecasted transfer capacities in 2016⁵.
12. The values provided by ENTSO-E have been converted from MW to MWh per year. Because the deliverable supply is calculated according to the peak delivery period (12 hours per days, Monday to Friday), the capacity expressed in MW needs to be multiplied by 12 (hours per day) and 260 (working days per year) to obtain a value in MWh per year.
13. The overall value was then divided by 12 in order to align the deliverable supply to the timeframe of the spot month period, i.e. one calendar month.

Spot month position limit

14. The spot month limit has been set at 5,340,219 MWh, which represents 15% of the deliverable supply. The spot month limit applies to daily contracts, weekly contracts and one monthly contract.

Spot month position limit rationale

15. The baseline figure for the spot month amounts to 25% of the deliverable supply, i.e. 8,900,364 MWh, as required by Article 9(1) of RTS 21.
16. The Italian Power Peak Future is a "less liquid" derivative contract according to Article 15(1)(b) of RTS 21 as the open interest is below 20,000 lots. Thus, the limit is to be set within a range of 5% to 40%.
17. BaFin considered the following factor relevant for adjusting the baseline downward:
 - Article 18(3) of RTS 21: the deliverable supply is significantly larger than the open interest (the deliverable supply is more than ten times higher than the open interest). In order to ensure that no position holder is able to hold excessive shares of overall open interest due to large deliverable supply / low open interest, position limit is to be set at a low percentage.
18. In sum, BaFin considers that applying 15% as a limit for the spot month is adequate.

⁴ <https://transparency.entsoe.eu/generation/r2/installedGenerationCapacityAggregation/show>

⁵ <https://transparency.entsoe.eu/transmission-domain/ntcYear/show>



Other months' position limit

Open interest

19. The open interest amounts to 3,372,612 MWh.
20. The 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, namely February, March and April 2018.

Other months' position limit

21. The other months' limit has been set at 1,045,510 MWh, which constitutes 31% of the reference amount. It includes monthly, quarterly and yearly contracts.

Other months' position limit rationale

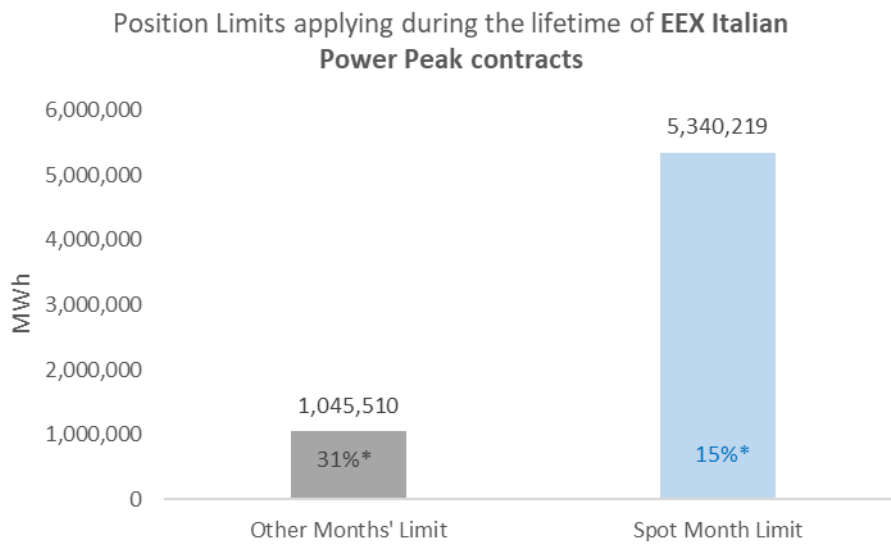
22. The baseline figure for the other months' limit amounts to 25% of open interest, i.e. 843,153 MWh, as required by Article 11(1) of RTS 21.
23. BaFin considered the following factors relevant for adjusting the baseline upwards:
 - Article 16(2) of RTS 21: there is a large number of separate expiries (seven monthly contracts, seven quarterly contracts and six yearly contracts);
 - Article 18(3) of RTS 21: the overall open interest is significantly lower than the deliverable supply (the open interest is more than ten times lower than the deliverable supply).
24. In sum, applying 31% as a limit for the other months seems adequate mainly because the open interest is significantly lower than the deliverable supply.

V. ESMA's Assessment

25. This Opinion concerns positions held in EEX Italian Power Peak Futures contracts.
26. ESMA has performed the assessment based on the information provided by the 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 position limit for the other months.



*Position limit as % of Open Interest

*Position limit as % of Deliverable Supply

Spot month position limit

29. The calculation of the deliverable supply is based on the domestic Net Generating Capacity (NGC) of Italy for the year 2016 and the average import capacity in relation to neighbouring countries forecasted in 2016. The source of data used to calculate deliverable supply (ENTSO-e statistics) ensures publicly available figures that are consistent at the European level.
30. ESMA considers that this methodology to calculate deliverable supply is consistent with Article 10(1) of RTS 21 that sets out that deliverable supply shall be calculated “by identifying the quantity of the underlying commodity that can be used to fulfil the delivery requirements of the commodity derivative.”
31. The monthly deliverable supply figure has been calculated by converting the capacity (expressed in MW) to MWh per month.
32. This approach is consistent with Article 10(2) of RTS 21, which 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”.

33. Compared with the baseline figure of 25% of deliverable supply, the spot month position limit has been adjusted downwards and set at 15% of deliverable supply.
34. ESMA considers that, since the deliverable supply is significantly larger than the open interest, a downward adjustment to the spot month limit can be made under Article 18(3) of RTS 21. Indeed, ESMA considers that the rationale underpinning Article 18(3) with respect to the other months' limit enables the national competent authority to adjust the spot month limit downwards in case the deliverable supply is significantly higher than the open interest.
35. Taking into account all of the above, ESMA considers reasonable to adjust the spot month limit downward.

Other months' position limits

36. The open interest was calculated as the daily average over three consecutive months of the number of open contracts that have not been closed out or expired. 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.
37. Compared to the baseline figure of 25% of overall open interest, the other months' position limit has been adjusted upward and set at 31% of the open interest.
38. ESMA agrees that an upward adjustment of the other months' position limit is justified in accordance with Article 18(3) of RTS 21 given that the deliverable supply is significantly higher than the open interest. ESMA also agrees that an upward adjustment is justified by the large number of separate expiries (which is consistent with Article 16(2) of RTS 21).
39. 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

40. 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.
41. 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 2018.
42. 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.

43. In light of the assessment above, ESMA considers that the position limits 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 EEX Italian Power Peak Futures contracts are not hampered

44. 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 EEX Italian 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

45. 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, 6 September 2019

Steven Maijoor

Chair

For the Board of Supervisors