

## OPINION on position limits on CEGH VTP natural gas Future contracts

### I. Introduction and legal basis

1. On 20 March 2020, 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 instruments<sup>1</sup> ("MiFID II") regarding the exact position limits BaFin has set for CEGH VTP natural gas 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. The contract used to be traded on Powernext until 1<sup>st</sup> of January 2020 when the trading has been moved to EEX following the merger between two entities.
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: natural gas (NGAS)

Commodity further sub product: other (OTHR)

Name of trading venue: EUROPEAN ENERGY EXCHANGE

MIC: XEEE

Venue product code: G8B

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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 CEGH VTP contract is a derivatives contract referring to the future physical delivery of gas into the Austrian market area through the Virtual Trading Point (VTP) of Central European Gas Hub AG (CEGH). The contract used to be traded at Powernext. However, trading of derivatives contracts on gas has been moved to EEX end of 2019 and since 01 January all prior Powernext gas contracts are traded at EEX.
4. 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.
5. The Austrian gas market is mainly supplied by Russian imports. Given its central position in Europe, Austria is a key market for Eastern countries to access the western European markets. Austria is also an important transit country for Russian flows to Italy. As for other markets, hedging activities typically takes place on the Dutch TTF contract.
6. Market participants at CEGH VTP can be classified as:
  - a) utilities, which have a gas portfolio (entry/exit capacities, storages capacities, consumption clients, ...) 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, ...) which enter the system for their own needs or for balancing purposes; or
  - e) trading companies which do not have a shipper or supply agreement in the market (banks, commodities
  - f) traders, investment firms, ...).
7. All the contracts are physically delivered via a nomination to the relevant TSO.
8. According to the Herfindahl-Hirschman-Index there is a moderate market concentration in the Austrian gas market. In recent years the market has been liberalised and grid, production and trading were unbundled. The estimated number of market participants is 55 and there are less than three market makers active in this market.

### **IV. Proposed limit and rationale**

*Spot month position limit*

### Deliverable supply

9. Deliverable supply amounts to 91,400,000 MWh.
10. The calculation of the deliverable supply is based on actual daily entry capacities of each of the source types described below to the Austrian CEGH-VTP 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 = 1,932 GWh/d in 2018<sup>4</sup>
  - 2) LNG import capacity = 0 GWh/d<sup>5</sup>
  - 3) Storage withdrawal capacity = 1,084 GWh/d in 2018<sup>6</sup>
  - 4) Average indigenous production in 2016 = 31 GWh/d in 2018<sup>7</sup>
11. The total deliverable supply sums up to 3,047 GWh/d. This equates (rounded) to 91,400,000 (3,047\*1000\*30) MWh/month.

### Spot month limit

12. Spot month limit amounts to 13,710,035 MWh, which corresponds to 15% of the deliverable supply.

### Spot month position limit rationale

13. Since the CEGH VTP Future 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.  $25\% * 91\,400\,235 \text{ MWh} = 22\,850\,058 \text{ MWh}$ .
14. There are no market makers. Thus, the limit is to be set within a range of 5% - 50%. Spot month is the next calendar month which is available to trade.
15. The following factors were considered relevant for adjusting the limit downwards:
  - Article 18(3) of RTS 21: the deliverable supply is significantly higher than the open interest. BaFin has applied a reverse interpretation of Article 18(3) of RTS 21 and therefore adjusted the spot month limit downwards; deviation from the baseline needs to

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<sup>4</sup> [https://www.entsog.eu/sites/default/files/2018-12/ENTSOG\\_GIE\\_SYSDEV\\_2017-2018\\_1600x1200\\_FULL.pdf](https://www.entsog.eu/sites/default/files/2018-12/ENTSOG_GIE_SYSDEV_2017-2018_1600x1200_FULL.pdf)

<sup>5</sup> Ibidem

<sup>6</sup> Ibidem

<sup>7</sup> [www.appsso.eurostat.ec.europa.eu](http://www.appsso.eurostat.ec.europa.eu); [http://wds.iea.org/wds/pdf/Gas\\_Documentation.pdf](http://wds.iea.org/wds/pdf/Gas_Documentation.pdf), page 48/49



be significant as position holders would otherwise be allowed to hold large spot month positions;

- Article 17 of RTS 21: Gas delivered in the Austrian market area via virtual trading point of CEGH as underlying is also used as the deliverable supply for other commodity derivatives in the EU, for instance at ICE Endex.

16. The following factors were considered as not relevant:

- overall open interest;

- volatility: volatility is considered limited, therefore it seems not relevant to adjust the limit.

17. In sum, BaFin considered that applying a spot month limit accounting for 15% of deliverable supply was adequate.

#### *Other months' position limit*

#### Open interest calculation methodology

18. Open interest amounts to 31,632,899 MWh.

19. The open interest value was calculated as the average of the daily open interest of all CEGH-VTP futures from 01 August 2019 to 31 October 2019. It was based on data provided by the European Commodity Clearing (ECC), i.e. the CCP of Powernext where the contract used to be traded before it was transferred to EEX in the course of a merger of Powernext with EEX. EEX had not listed the contract until 01 January 2020. From 31 December 2019 to 01 January 2020 all trading at Powernext ceased and started at EEX simultaneously. Accordingly, all positions held at Powernext were completely transferred to EEX.

20. The open interest has been calculated by aggregating all contracts across all maturities and converting them into MWh. Furthermore, the calculation is based on the assumption that the open interest at EEX will remain more or less the same as at Powernext. BaFin is closely monitoring the development of open interest.

#### Other months' limit

21. Other months limit amounts to 11,071,515 MWh, which corresponds to 35% of the open interest.

#### Other months' position limit rationale

22. The baseline figure for the other months limit amounts to 25% of open interest, i.e. 7,908,225 MWh.

23. The following factors were considered relevant for adjusting the baseline upwards:

- Article 16(2) of RTS 21: There is a large number of separate expiries in the GPL gas contract. For a given trading day, EEX lists CEGH VTP derivative contracts for the next 6 months, the next 7 quarters, the next 6 seasons and the next 6 calendar years. This means that 25 instruments are listed in this market each day. In total, 41 different CEGH VTP derivatives instruments can be traded each year.

- Article 18(3) of RTS 21: the overall open interest is significantly lower than the deliverable supply, in accordance with Article 18 (3) of Commission Delegated Regulation (EU) 2017/591 the other months limit is therefore to be adjusted upwards.

24. The following factors were considered as not relevant:

- volatility: volatility is considered limited, therefore it seems not relevant to adjust the limit.

25. In sum, BaFin considered that applying 35% of the reference amount as the other months' limit was adequate.

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

26. This Opinion concerns positions held in CEGH VTP natural gas Future contracts.

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

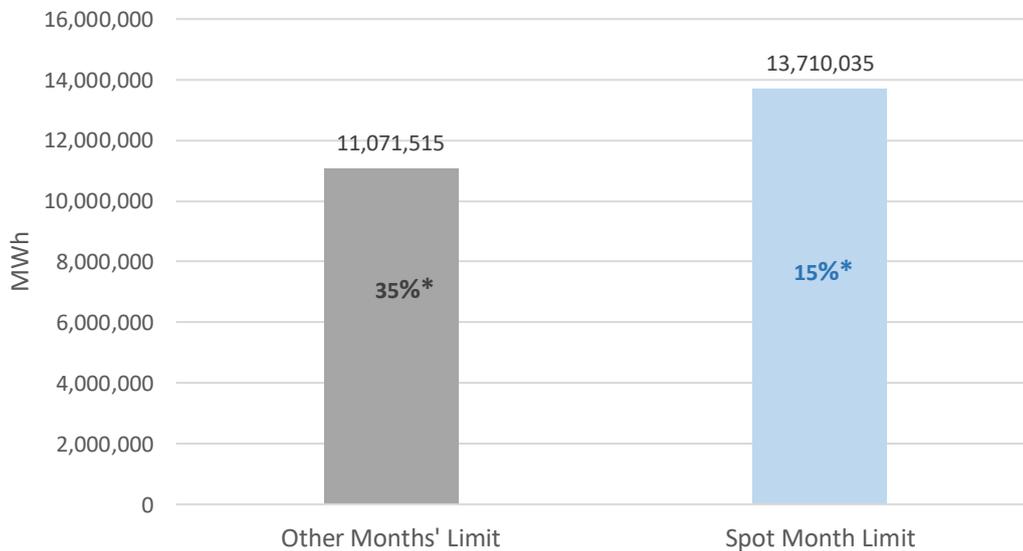
28. For the purposes of this Opinion, ESMA has assessed the compatibility of the intended position limits with the objectives of Article 57(1) of MiFID II and with the methodology for calculation of position limits established in RTS 21, in accordance with Article 57(3) of MiFID II.

29. Since the contract was traded before on Powernext until January 2020, until the merger between EEX and Powernext took place, ESMA considers that this is a continuation of trading in the previously existing contract, rather than the newly created one. Therefore, it seems appropriate to use the previously observed OI level on Powernext, for the purpose of setting the relevant position limits.

*Compatibility with the methodology for calculation of position limits established in RTS 21 in accordance with Article 57(3) of MiFID II*

30. BaFin has set one position limit for the whole spot month and one for the other months.

Position Limits Applying During the Lifetime of an EEX CEGH-VTP natural gas contracts



\* Position Limit as % of Open Interest

\* Position Limit as % of Deliverable Supply

### Spot month position limit

31. The estimation of deliverable supply for natural gas is calculated by aggregating Austrian gas local production, the imports and transmission capacity from neighbouring countries and the average withdrawal rate from storage facilities.
32. 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".
33. Taking into account that the deliverable supply is significantly higher than the open interest and the fact that the deliverable supply is also used for other contracts with the same underlying, ESMA considers it appropriate to adjust the spot month limit downwards, accordingly to Articles 17 and 18(3) of the RTS 21.

### Other months' position limit

34. The open interest was calculated as the daily average over the period from August to October 2019 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.

35. Compared to the baseline figure of 25% of overall open interest, the other months' position limit has been adjusted upward 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. Additionally, the other months' limit has been adjusted upwards considering large number of separate expiries as per Article 16(2) of RTS 21. Overall, the other months' limit of 35% of the overall open interest seems adequate.
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. Based on the information provided by the competent authority ESMA notes that the spot month limit far exceeds the open interest in the CEGH VTP natural gas contracts in the spot month.
38. 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 in the spot month.
39. 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 CEGH VTP contracts are not hampered.
40. However, to help ensure that the objectives set out in Article 57(1) of MiFID II are met, ESMA considers that trading patterns in CEGH VTP 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**

41. 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,

Steven Maijoor

Chair

For the Board of Supervisors