

OPINION on position limits on Phelix DE Base Power contracts

I. Introduction and legal basis

1. On 1 October 2020, 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 instruments¹ ("MiFID II") regarding the exact position limits BaFin intends to set for the Phelix DE Base Power Futures and Options 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. Additional information was received on 16 October 2019.
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.
3. On 24 January 2020, ESMA issued a first Opinion regarding the exact position limits BaFin intended to set for the Phelix DE Base Power Futures and Options commodity contracts. The position limits considered by BaFin in October 2018 was 40,416,961 MWh for the spot month limit and 209,747,820 MWh for the other months' limit. In this opinion, ESMA concluded that the position limits considered by BaFin complied with the methodology established in RTS 21 and were consistent with the objectives of Article 57 of MiFID II.
4. According to Article 57(4) of MiFID II, a competent authority shall review position limits where there is a significant change on the market, based on its determination of deliverable supply and open interest and reset the position limit. Whereas the open interest underpinning the position limits set out in BaFin's initial submission had been calculated based on the information provided by the trading venue, BaFin has calculated again the open interest in the course of 2020 based on position reporting data. BaFin considered that there had been a significant decrease in the revised open interest compared to its initial submission to the extent that the position limit had to be reset for both the spot month limit and the other

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 December 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).



months' limit. ESMA understands that the new position limits will apply upon publication of this opinion and replace the previous position limits as determined by BaFin. In this opinion, ESMA is assessing whether the new position limits BaFin intends to set for the Phelix DE Base Power Futures and Options commodity contracts comply with the methodology established in RTS 21 and are consistent with the objectives of Article 57 of MiFID II.

II. Contract classification

Commodity base product: energy (NRGY)

Commodity sub product: electricity (ELEC)

Commodity further sub product: base load (BSLD)

Name of trading venue: EUROPEAN ENERGY EXCHANGE

MIC: XEEE

Venue product codes: DEB and O2B

III. Market description

5. The Phelix DE Power Future and Option contracts are commodity derivatives referring to the average power spot market prices of future delivery periods regarding the German market area. Since 1 October 2018 the common German-Austrian market area has been split into national market areas. As a consequence, the corresponding contract types (Phelix DE/AT) have been replaced by stand-alone contracts for the German market area and for the Austrian market area. As a consequence, the Phelix DE contract type is constantly gaining liquidity whereas Phelix DE/AT is losing liquidity. The Phelix DE has become a benchmark contract that does also serve as proxy hedging tool for other, smaller market areas with less liquid derivative contracts.
6. The Physical Electricity Index (Phelix) refers to the base load (Phelix Base) and peak load (Phelix Peak) price index published daily on the Power Spot Market for the German market area. The Phelix is established by EPEX (European Power Exchange) SPOT and constitutes the underlying asset for the European Energy Exchange (EEX) Phelix Futures contract.
7. The Phelix DE Base Futures contracts are financially settled derivatives contracts referring to the average power spot market prices of future delivery periods of the German market area. Maturities in the Phelix DE Baseload Futures include Day, Week, Weekend, Month, Quarter and Year contracts. The furthest maturity to trade is 6 years.
8. EEX also offers trading in options on the Phelix-DE Base Future (Month, Quarter, Year). In addition, EEX offers four expiry dates for options on Phelix-DE Base Year Futures, the so-called Short Dated Options. Regardless of the different maturities, the corresponding futures position of the underlying asset is booked upon exercising of the option.

9. 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. Since the electricity system constitutes critical infrastructure the German power market is subject to close surveillance of national and European regulators, including supervision for the purpose of the prevention of abusive practices of dominant positions.
10. Today, there is a high number of producers in Germany. The electricity market is characterised by two contradictory developments. On the one hand, more and more renewable energy generation facilities and new generation companies are entering the market, resulting in a steady decrease in wholesale prices and margin pressure for conventional power plants. On the other hand, former German market leaders RWE and E.ON have divided their businesses, rendering RWE a pivotal supplier. Nevertheless, according to a recent market power report⁴, the Federal Cartel Office found that there is currently no dominant power generating company. However, the situation could change in the future as a result of the phase-outs of nuclear and coal power.

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

11. Deliverable supply amounts to 167,964,118 MWh.
12. 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 as displayed on the Website of ENTSO-E for the year 2019 (219,667 MW) and the average yearly import capacity of Germany for 2020 (10,421 MW).
13. 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 (30 days).

Spot month position limit

⁴https://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2019/19_12_2019_Marktmachtbericht.html;jsessionid=D1D51218B0CB10BB4263E31B9B03877C.1_cid378?nn=3591568

14. The spot month limit is set at 41,991,030 MWh, which represents 25% of the deliverable supply. The spot month limit applies to Phelix DE Base Futures and Options contracts. The spot month (=calendar month) includes daily contracts, weekend contracts, weekly contracts and monthly contract. However, most positions are regularly concentrated on the monthly contract resulting in a stable amount of positions during the spot month period. Therefore, it was abstained from applying a decreasing position limit or a downward adjustment due to short maturities.

Spot month position limit rationale

15. Since the Phelix DE Power Future and Power Option contracts are not food contracts, the baseline figure for the spot month, which is based on deliverable supply, was calculated as 25% of the estimated deliverable supply, i.e. $25\% * 167\,964\,118 \text{ MWh} = 41\,991\,030 \text{ MWh}$. No financial institute is acting as market maker. Thus, position limits can be set in a range between 5% and 50% of deliverable supply.

16. All adjustments factors have been considered by BaFin and are not regarded as material or relevant to require adjustments, either up or down, from the baseline. In considering the volatility in the contract, as required by Article 21 of RTS 21, BaFin has noted that there has been some variation in the price of the commodity derivative but has not found evidence that this is excessive or that lower position limits would reduce volatility.

17. Based on the above, BaFin considered that it was appropriate to set the spot month limit at 41,991,030 MWh representing 25% of the deliverable supply.

Other months' position limit

Open interest

18. Open interest amounts to 246,196,532 MWh. The open interest has been calculated on basis of the reports of daily net positions submitted to BaFin pursuant to Article 58 MiFID II. The absolute values of daily net positions per position holder have been added up and divided by the factor 2 ("net approach"). The number provided is the average size of daily open interest throughout the first half year 2020. Option positions have already been reported to BaFin delta adjusted.

Other months' position limit

19. The other months limit amounts to 67,437,064 MWh, which represents 27% of the overall open interest. The other months' limit applies to Phelix DE Base Futures and Options contracts.

Other months' position limit rationale

20. The baseline figure for the other months limit amounts to 25% of open interest, i.e. to 61,549,133 MWh.

21. BaFin considered the following factor relevant for adjusting the baseline upwards:
- The Phelix DE Base Futures contract has a large number of separate expiries (10 monthly contracts, 11 quarterly contracts and 6 yearly contracts) – (Article 16(2) of RTS 21). In contrast to daily and weekly contracts that fall into the spot month, quarterly and yearly contracts are traded in significant volumes.
22. All the other potential adjustment factors set out in RTS 21 have been considered by BaFin and are not regarded 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, BaFin has noted that there has been some variation in the price of the commodity derivative but has not found evidence that this is excessive or that lower position limits would reduce volatility.
23. Based on the above, BaFin considered that it was appropriate to increase the baseline figure for the other month' limit by two percentage points. This results in a limit of 67,437,064 MWh representing 27% of the open interest.

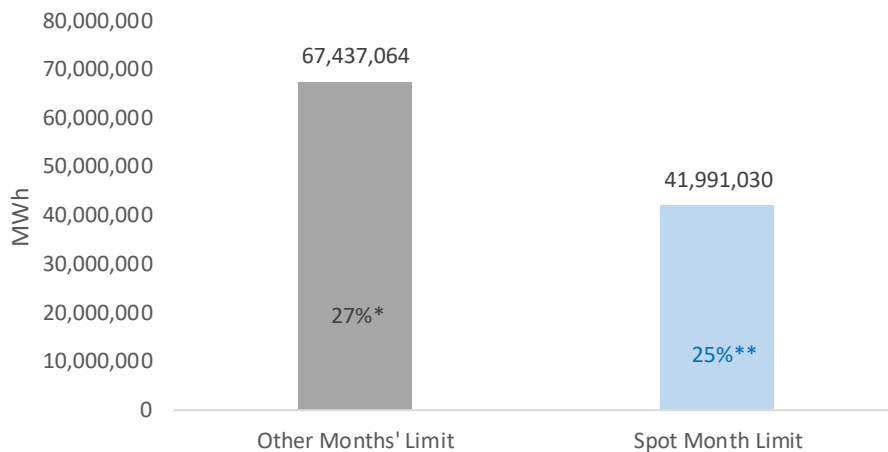
V. ESMA's Assessment

24. This Opinion concerns positions held in Phelix DE Base Power Futures and Options contracts.
25. ESMA has performed the assessment based on the information provided by BaFin.
26. 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

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

Position Limits applying during the lifetime of an EEX Phelix DE Base Power contract



*Position limit as % of Open Interest

**Position limit as % of Deliverable Supply

Spot month position limit

28. The calculation of the deliverable supply is based on ENTSO-e figures for 2019 as regard domestic Net Generation Capacity and for 2020 as regard import capacities into Germany.
29. ESMA agrees with the methodology used to include both domestic generation plus imports into Germany. Whilst the physical delivery of power depends on the actual number of days of the month, ESMA also agrees with using 30 days (average calendar days in a month) and 24h per day to calculate monthly deliverable supply, in order to standardize the monthly deliverable supply of power for these baseload contracts. 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”.
30. Considering the characteristics of the Phelix DE Base Power contract, ESMA considers as a reasonable approach not to have adjusted the spot month limit from the baseline.

Other months' position limit

31. The open interest has been calculated by BaFin based on position reporting data where the daily net positions have been added up and divided by the factor 2 ("net approach"). The number provided is the average size of daily open interest throughout the first half year 2020. ESMA considers that such calculation of open interest by the competent authority provides



the most accurate and reliable figure and promotes convergence in the setting of position limits by competent authorities. ESMA is also of the view that taking the first half of 2020 as a reference period is 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.

32. ESMA considers as a reasonable approach to have slightly adjusted the other months' limit upwards under Article 16(2) of RTS 21 due to the large number of separate expiries.
33. 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

34. 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) of MiFID II.
35. Overall, the position limits set for the spot month and the other months appears to achieve a reasonable balance between the need to prevent market abuse and to ensure orderly pricing and orderly settlement, while also ensuring that the development of commercial activities in the underlying market and the liquidity of the Phelix DE Base Power contracts are not hampered.

VI. Conclusion

36. 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 also complies with the methodology established in RTS 21 and is consistent with the objectives of Article 57 of MiFID II.

Done at Paris, 2nd December 2020

A handwritten signature in blue ink, appearing to be 'S/M' with a flourish.

Steven Maijoor

Chair

For the Board of Supervisors