European Securities and Markets Authority

Date: 18 January 2019
ESMA70-155-1124

OPINION on position limits on Dutch Power Physical Peak contracts

I. Introduction and legal basis

1. On 6 November 2017, the European Securities and Markets Authority ("ESMA") received a notification from the Netherlands Authority for the Financial Markets ("AFM") under Article 57(5) of Directive 2014/65/EU on markets in financial instruments[1] ("MiFID II") regarding the exact position limits the AFM intends to set for Dutch Power Physical 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 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: other (OTHR)

Name of trading venue: ICE ENDEX DERIVATIVES B.V.

MIC: NDEX

Venue product code: DPA

[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, p84).

III. Market description

1. The ICE ENDEX DERIVATIVES B.V. contract for Dutch Power Peak refers to the trading of power that is generated in the Netherlands and received from the other countries the Netherlands is connected to (Belgium, Germany, Norway and United Kingdom (UK)). The contract is traded in lots and a lot is equivalent to 1 MW (1,000,000 Watts). The minimum trading size is 1 lot. There are monthly future contracts available and the contracts are physically settled. Months, quarters and years are listed in parallel. The delivery is made each hour throughout the delivery period from 00:00 (CET) on the first day of the month until 24:00 (CET) on the last day of the month. The contract price is in Euros and Euro cents per MWh.

2. The Dutch power generation market is moderately concentrated, with four major players: Nuon/Vattenfall, Essent/RWE, E.ON and Electrabel/GDF Suez. Being the second largest gas producer in Europe, the electricity market in The Netherlands has been dominated by gas-fired generation (61%).

3. Changing conditions in the Dutch power and gas markets along with policy changes implemented by the government however means that most new capacity will be coal-fired (15%) or based on wind generation (13%). The Netherlands continues to back additional renewable energy resulting in an increase in renewable capacity of 1.5GW in 2016 and this trend is expected to continue in the coming years mainly with the roll-out of offshore wind energy.

4. The power generation from hard coal plants decreased because of the closure and decommissioning of several coal plants. The generation from gas-fired power plants increased significantly, partly to replace the generation from the decommissioned coal plants but more importantly due to the significant increase in margins for electricity generation with gas-fired plants. The share of wind generation increased by about 30% from 2015 to 2016. Demand has been in slight decline over the last few years, partially as a result of high electricity prices and milder winters, but is expected to be increasing again with the economic growth and the expected move from fossil fuels to electricity.

5. The Dutch market tends to import German wind and solar generation and Norwegian hydro. The grid currently has interconnectors to four countries. There is the 700MW NorNed link to Norway, the 1GW BritNed cable to the UK, two interconnectors to Belgium totalling 2.7GW and three interconnectors to Germany totalling 3GW. Additionally, an interconnector to Denmark is expected to be in operation in early 2019.

IV. Proposed limit and rationale

Spot month position limit

<u>Deliverable supply calculation methodology</u>

6. Deliverable supply amounts to 9,429,024 MWh.

7. The Dutch electricity physical market is part of the North-Western Europe (NWE) coupling area. The Net Generating Capacity (in MW) in 2017 for the Netherlands was 31,749 MW (https://transparency.entsoe.eu/generation/r2/installedGenerationCapacityAggregation/show). Given the NWE market mechanism, the quantity of the power that can be used to fulfil the delivery requirements of the various Dutch Power contracts should take into account the local production capacity of the Netherlands as well as the production capacity of the other countries (Belgium, Germany, Norway and the United Kingdom) for which there is an interconnector to the Netherlands.[4]

8. The Dutch Power hub total deliverable supply including net transmission capacity (NTC) as of 2016 is composed as follows: Netherlands (Installed Capacity) 31,749 + Belgium (NTC) 950 + Germany (NTC) 1,468 + Norway (NTC) 533 + United Kingdom (NTC) 1,016 = Total Deliverable Supply of 35,716 MW. The aggregated Dutch Power Physical Peak contracts are traded in lots for which 1 lot equals 1 MW.

9. Because the Deliverable Supply is calculated according to the peak delivery days in a month (22 days), the capacity need to be multiplied by 12 (hours) and 22 (days). Therefore, a unit conversion of 264 is required between the lot size and the underlying deliverable. The deliverable supply for the spot month period and according to this methodology is 9,429,024 MWh.

Spot month position limit

10. The spot month limit is 2,262,967MWh, which represents 24% of deliverable supply. The spot month position limit applies to the Dutch Power Physical Peak futures contracts. There are no options on this contract at the present time.

Spot month position limit rationale

11. The baseline for the spot month has been set at 25% as required by Article 9(1) of RTS 21. The contract can have a position limit set between 5-50% as set out in Article 19(2)(b) of RTS 21 as there is no investment firms acting as a market maker in accordance with Article 4(1)(7) of Directive 2014/65/EU.

12. AFM considered the following factor relevant for adjusting the baseline downwards:

- Article 17 of RTS 21: 11% of the total deliverable supply comes from interconnectors and can be delivered to other countries.

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 AFM has not found evidence that this is excessive or that lower position limits would reduce volatility.

[4] https://transparency.entsoe.eu/transmission-domain/ntcYear/show

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

15. Given the characteristics of the contract, the AFM has decided to set a total downward adjustment of 1-percentage point resulting in an adjusted baseline of 24% of deliverable supply. This provides a figure of 2,262,967 MWh.

Other months' position limit

Open interest

16. The open interest amounts to 3,324,053 MWh. In the Dutch Power Physical Peak market, there are no overlapping contracts. The Open Interest figure is calculated as the daily average of Open Interest over 2016. The Dutch Power Physical Peak open interest figures are published on the ICE Endex website Report Center.[5]

17. There are no EETOC or same contracts identified.

Other months' position limit

18. The other months limit amounts to 1,329,621 MWh, which represents 40% of open interest. The other months' position limit applies to Dutch Power Physical Peak Futures.

Other months' position limit rationale

19. The baseline for the other months limit has been set at 25% as required by Article 11 of RTS 21. The contract can have a position limit set between 5-50% as set out in Article 19(2)(b) of RTS as there is no investment firms acting as a market maker in accordance with Article 4(1)(7) of Directive 2014/65/EU.

20. AFM considered the following factors relevant for adjusting the baseline upwards:

- Article 16 of RTS 21: This contract has a relative large amount of separate expiries in other months (59). According to Article 16 of RTS 21, where the commodity derivative has a large number of separate expiries, competent authorities shall adjust the position limit upwards.

- Article 18 of RTS 2: Open interest is 35% of deliverable supply and in this case competent authorities shall adjust the position limit upwards according to Article 18(3).

- Article 20(2)(d) of RTS 21: There is a limited number (6) of daily active market participants that are involved in trading. In addition, market participants have

[5] https://www.theice.com/marketdata/reports/159

a relatively large position in the physically delivered power derivatives market and they operate facilities with substantial generation capacity or large demand assets.

21. 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 AFM has not found evidence that this is excessive or that lower position limits would reduce volatility.

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

23. Given the characteristics of this contract, the AFM has de decided to set a total upward adjustment of 15-percentage points resulting in an adjusted baseline of 40% of open interest. This provides a figure of 1,329,621 MWh.

V. ESMA's Assessment

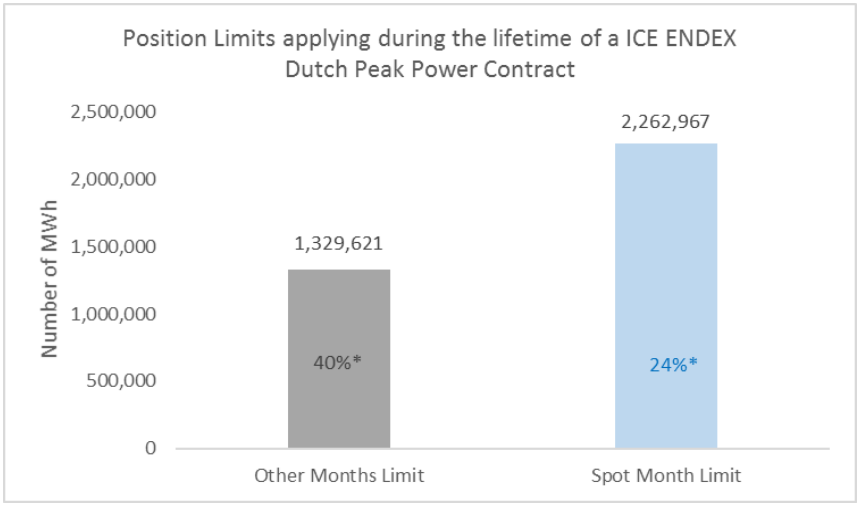
24. This Opinion concerns positions held in Dutch Power Physical Peak contracts

25. ESMA has performed the assessment based on the information provided by the AFM.

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. The AFM has set one position limit for the spot month and another position limit for the other months.



*Position limit as % of Open

*Position limit as % of Deliverable

Spot month position limit

28. 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 the Netherlands based on the capacity of the interconnectors of the Netherlands to neighbouring countries, as this energy would also be available for delivery.

29. While the physical delivery of power depends on the actual days of the month, ESMA agrees also with using a standard average of 22 days (instead of the average calendar days in a month) and 12h per day to calculate deliverable supply, as these are the days on which power is actually delivered for these peak contracts.

30. The approach followed 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".

31. ESMA agrees with the downward adjustment made by AFM under Article 17 as 11% of the total deliverable supply comes from interconnectors and can be delivered to other countries.

Other Months' Limit

32. ESMA considers that using a daily average open interest for 2016, which is the latest calendar year for which annual data was available at the time of the notification, is sensible as it gives a more stable measure of open interest and considers such approach consistent with Article 12 of RTS 21.

33. ESMA considers the upward adjustment made under Article 16 as appropriate given that the contract has a large number of separate expiries.

34. ESMA also agrees with the upward adjustment made under Article 18(3) as open interest is significantly lower than the deliverable supply.

35. ESMA also agrees with upward adjustment made under Article 20(2)(d) given the limited number of daily market participants active in trading and their role in the underlying commodity market.

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. 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.

38. Overall, 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 market and the liquidity of this contract are not hampered.

39. However, ESMA notes that the spot month limit is more than 10 times the maximum open interest reached in the spot month in 2016 for this contract (213,900 MWh). ESMA is of the view that the application of the methodology set in RTS 21 needs to fulfil the objectives set in Article 57(1) MiFID II. ESMA is therefore of the opinion that the maximum level of open interest in the spot month needs to be taken into consideration when setting the spot month position limit, in addition to the amount of deliverable supply.

40. ESMA therefore recommends the competent authority to monitor the effect of this limit on the market and to revise it if necessary.

VI. Conclusion

41. 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. In addition, the other months' position limit complies with the methodology established in RTS 21 and is consistent with the objectives of Article 57 of MiFID II.

Done at Paris, 18 January 2019

Steven Maijoor

Chair

For the Board of Supervisors