European Securities and Markets Authority

Date: 23 May 2019
ESMA70-155-2925

OPINION on position limits on EEX French Power Peak contracts

I. Introduction and legal basis

1. On 20 October 2017, 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 the French 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 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: Peak Load (PKLD)

Name of trading venue: European Energy Exchange

MIC: XEEE

Venue product code: F7P

[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).

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III. Market description

3. The French Power Peak Future is a derivative contract referring to the average power spot market price of future delivery periods of the French market area. The contract can be either physically delivered or 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 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. According to DG Energy's country report on France[4] both wholesale and retail electricity markets are highly concentrated. The French electricity market is characterised by the dominant position of Electricité de France (EDF) which is the country's main electricity generation and distribution company. It manages the country's 58 nuclear power reactors that were producing about 72% of the country's total electricity production in 2016, which is the highest share of nuclear power in the world. Renewables and fossil fuels accounted for 17.8 % and 8.6% of the production of electricity in France.

6. In 2016 France exported 71,7 TWh whereas the imports amounted only to 32,6 TWh. EDF is substantially owned by the French Government, with around 85% shares in government hands. Moreover, RTE (Réseau de Transport d'Electricité) which owns and manages the electricity transmission network, is majority-owned by EDF. However, compared to other countries in the EU the average price of electricity is relatively low.

7. The wholesale market in France has low liquidity with the majority of trading taking place OTC.

8. The underlying of the French Power Peak Contract is the delivery or acceptance of delivery of French 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, weekend, week, month, quarter and year.

9. With respect to French Power Peak futures contracts, at maximum, the following maturities can be traded: for "Day Futures" the respective next 34 days; for "Weekend Futures" the respective next 5 weekends; 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.

[4] https://ec.europa.eu/energy/en/topics/markets-and-consumers/single-market-progress-report

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

10. Deliverable supply amounts to 36,485,856 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) of France as displayed in the Statistical Factsheet for the year 2016 and the average import capacities of its neighbouring countries for 2017.

12. The values provided by ENTSO-E have been converted from MW to MWh per year. The overall value was then divided by 12 in order to align the deliverable supply to the timeframe of one calendar month for the spot month period.

Spot month position limit

13. The spot month limit has been set at 4,378,303 MWh, which represents 12% of the deliverable supply. The spot month limit applies to daily contracts, weekend contracts, weekly contracts and one monthly contract.

Spot month position limit rational

14. The baseline figure for the spot month amounts to 25% of the deliverable supply, i.e. 9,121,464 MWh, as required by Article 9(1) of RTS 21. There are only 2 market makers. Thus, the limit is to be set within a range of 5% - 50%.

15. BaFin considered the following factors relevant for adjusting the baseline downwards:

- Article 17 of RTS 21: French power is also used as the deliverable supply for other commodity derivatives in the EU, for instance at ICE Endex;

- Article 20(2)(d) of RTS 21: power generation in France remains fairly concentrated. This factor needs to be taken into account as spot and futures market in power are closely intertwined. Measures to limit large speculative positions in the derivatives market can help to prevent these positions from negatively impacting competition in the underlying.

- Article 18(3) of RTS 21: the deliverable supply is significantly larger 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.

16. All other factors 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 consider-

ing 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.

17. In sum, BaFin has adjusted the spot month's limit downward, and has set that limit at 12% of deliverable supply.

Other months' position limit

Open interest

18. The open interest amounts to 5,545,200 MWh.

19. 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 April, May and June 2017.

Other months' position limit

20. The other months' limit has been set at 1,552,656 MWh, which constitutes 28% of the reference amount. It includes monthly, quarterly and yearly contracts.

Other months' position limit rationale

21. The baseline figure for the other months' limit amounts to 25% of open interest, i.e. 1,386,300 MWh, as required by Article 11(1) of RTS 21.

22. 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 (six monthly contracts, seven quarterly contracts and six yearly contracts). In contrast to daily and weekly contracts, quarterly and yearly contracts are traded in significant volumes;

- Article 18(3) of RTS 21: the overall open interest is significantly lower than the deliverable supply (the open interest is more than six times lower than the deliverable supply).

23. In accordance with Article 21 of RTS 21, BaFin has assessed the volatility in the price of the underlying commodity. The volatility is considered limited and therefore BaFin considers that the volatility is not a relevant factor to adjust the limit.

24. In sum, applying 28% as limit seems adequate as the open interest is significantly lower than the deliverable supply.

V. ESMA's Assessment

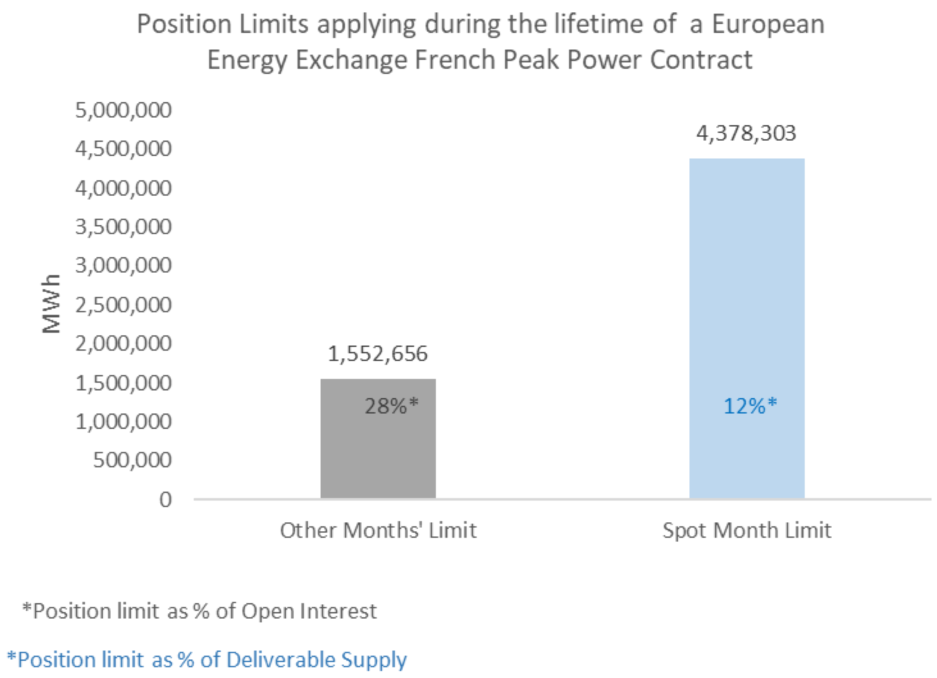
25. This Opinion concerns positions held in French Power Peak contracts.

26. ESMA has performed the assessment based on the information provided by 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.



<u>Spot month position limit</u>

29. The calculation of the deliverable supply is based on the domestic Net Generating Capacity (NGC) of France for the year 2016 and the average import capacity in relation to neighbouring countries forecasted in 2017. 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 downward and set at 12% of deliverable supply.

34. ESMA considers that, since the deliverable supply is significantly larger that 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. In addition, ESMA agrees that a downward adjustment to the spot month limit is justified by (1) the fact that the deliverable supply is used also as the deliverable supply for other commodity derivatives (which is consistent with Article 17 of RTS 21); and (2) the fact that the French Power market is a relatively closed market with a limited set of suppliers (which is consistent with Article 20(2)(d)).

36. Taking into account all of the above, ESMA considers reasonable to adjust the spot month limit downward.

<u>Other months' position limits</u>

37. 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.

38. Compared to the baseline figure of 25% of overall open interest, the other months' position limit has been adjusted upward and set at 28% of the open interest.

39. 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).

40. 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

41. 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.

42. 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 2017.

43. 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.

44. In light of the assessment above, ESMA considers that the position limit 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 French Power Peak Futures contracts are not hampered

45. 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 French 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

46. 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, 23 May 2019

Steven Maijoor

Chair

For the Board of Supervisors