European Securities and Markets Authority

Date: 15 April 2019
ESMA70-155-3655

OPINION on position limits on Belgian Power Baseload Futures contract

I. Introduction and legal basis

1. On 3 October 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 Belgian Power Baseload 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: BPB

[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

3. The Belgian Power Baseload Futures contract for Belgian power refers to the trading of power that is generated in Belgium and received from the other countries Belgium is connected to. Contracts are priced in Euro and are physically settled. Delivery takes place in megawatt per quarter hour. The trading volume is settled in lots and a lot is equivalent to 1 MW (1,000,000 Watts). Months, quarters and years are listed in parallel. Quarters are strips of three individual and consecutive months. Quarters always comprise a strip of January-March, April-June, July-September or October-December. Years are strips of twelve individual and consecutive contract months comprising January-December.

4. Incumbent Electrabel (owned by GDF Suez) has a major share of production in the Belgian power market. Electrabel had a share of 65% in electricity generation capacity in 2015, followed by EDF Luminus (12%) and E.ON (9%). Nuclear (29%) and gas (32%) are now Belgium's main electricity sources, providing the vast majority of the country's electricity. Electricity generation has been falling in recent years due to long and extensive outages at the country's nuclear power plants.

5. The use of gas for electricity generation is also in decline as imports from cheaper sources and wind (11%) and solar (15%) power have gained ground. Compared to most other European countries Belgium has a low share of fossil fuels in electricity generation while its nuclear (29%) share is among the highest. If the pursued phase-out of nuclear generation will follow through, the whole nuclear power capacity will be shut down by 2025 and lead to major changes in the power market. Dependency on gas will be increased and the development of additional renewable energy sources will be costly and likely increase electricity prices, yet necessary in order to meet targets set to reduce carbon emissions.

6. During the 10-year period from 2004 to 2014 the consumption of electricity by households reduced much faster in Belgium (-28.6%) than it did in the total EU (-1.3%), yet total electricity demand has been relatively stable in the past years. Belgium is well interconnected and generally a net importer of electricity, notably from France and the Netherlands. Currently relatively limited direct cross-border capacity with Germany is available, but additional capacity will become available in 2019. Additionally a 1GW inter-connector with the UK is in development, to be operational in 2019, which should lead to greater security of supply.

IV. Proposed limit and rationale

Spot month position limit

<u>Deliverable supply</u>

7. Deliverable supply amounts to 16,845,840 MWh.

8. The Belgium electricity physical market is part of North-Western Europe (NWE) coupling area, therefore the net figure for the total delivery supply volume is achieved by adding

Belgium's own self electricity generation capacity to the net transmission capacity (NTC) from each interconnector linked to Belgium (France and the Netherlands).

9. The net generating capacity as published by ENTSO-E for Belgium is 20,597 MW in 2017 (https://transparency.entsoe.eu/generation/r2/installedGenerationCapacityAggregation/show). Another component of deliverable supply is the Net Transmission Capacity (NTC) from connected neighbouring area's. When applied to the Belgian Power hub, the NTC per applicable interconnector in 2016 is equal to France (1,850 MW) and the Netherlands (950 MW) (Source: NTC: https://transparency.entsoe.eu/transmission-domain/ntcYear/show).

10. The Belgian Power hub total deliverable supply including NTC is composed as follows: Belgium (Installed Capacity) 20,597 MW + France (NTC) 1,850 MW + Netherlands (NTC) 950 MW = Total Deliverable Supply 23,397 MW.

11. Because the deliverable supply has to be calculated in MWh per standard month (30 days) the capacity needs to be multiplied by 24 (hours) and 30 (days). Therefore, a unit conversion of 720 is required between the lot size and the underlying deliverable. The deliverable supply is 16,845,840 MWh.

Spot month position limit

12. The spot month limit is 4,218,480 MWh, which represents 25% of the deliverable supply.

Spot month position limit rationale

13. As the daily average Open Interest throughout 2016 is between 7,200,000 MWh (10,000 lots) and 14,400,000 MWh (20,000 lots), according to Article 15(b) of RTS 21, the Belgian Power Baseload Futures contract is classified as a 'less liquid' market with a baseline limit of 25% and a standard range of the limit between 5% and 40%.

14. The AFM has considered all potential factors, including the volatility in the contract as required by Article 21 of RTS 21, and none of them have been regarded as material or relevant to require an adjustment, either up or down for the spot month limit.

15. As no adjustment was made to the baseline, this provides a spot position limit of 4,218,480 MWh.

Other months' position limit

Open interest

16. The open interest amounts to 8,110,817 MWh. In the Belgian Power Baseload Futures contract there are no overlapping contracts. The Open Interest figure is calculated as the daily average of open interest for the on venue contracts during the calendar year 2016. Open Interest figures are published on the ICE Endex website Report Center (https://www.theice.com/marketdata/reports/159).

Other month's position limit

17. The other months' limit is set at 3,244,326 MWh, which represents 40% of open interest. This limit applies to yearly, quarterly and monthly futures.

Other months' position limit rationale

18. As the daily average Open Interest throughout 2016 is between 7,200,000 MWh (10,000 lots) and 14,400,000 MWh (20,000 lots), according to Article 15(b) of RTS 21, the Belgian Power Baseload Futures contract is classified as a 'less liquid' market with a baseline limit of 25% and a standard range of the limit between 5% and 40%.

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

- Article 16(2) of RTS 21: This contract has a relative large amount of separate expiries in other months, including 47 separate expiries of monthly futures contracts, which would warrant an upward adjustment.

- Article 18(3) of RTS 21: The open interest (8,110,817 MWh) is about half of deliverable supply (16,873,920 MWh). The AFM considers this requires an upward adjustment.

20. 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.

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

22. Given the characteristics of this contract, the AFM has decided to set a total upward adjustment of 15 percentage points resulting in an adjused baseline of 40% of open interest. This provides another months' position limit of 3,244,326 MWh.

V. ESMA's Assessment

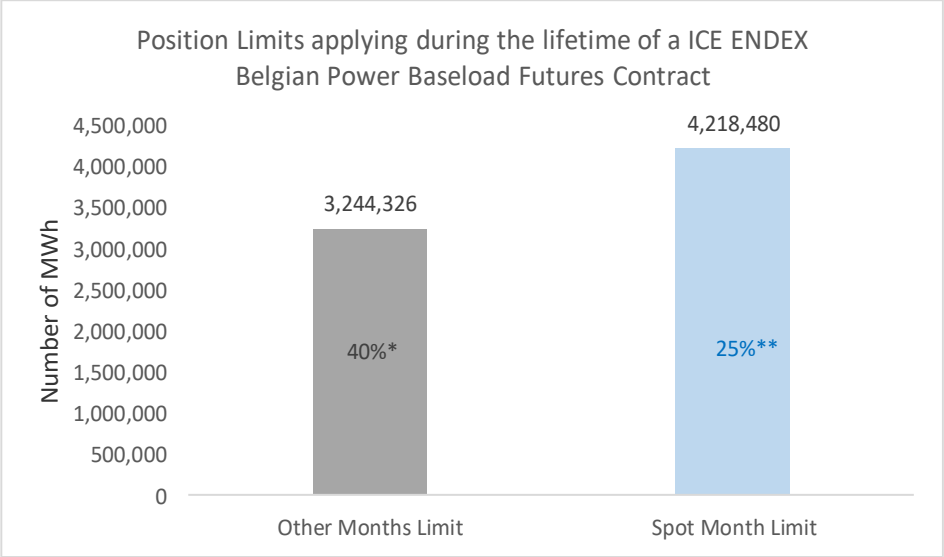
23. This Opinion concerns positions held in Belgian Power Baseload Futures contracts.

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

25. 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

26. The AFM 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

27. The calculation of the deliverable supply is based on average data over the year 2017 for the local Belgian electricity production and the NTC from France and the Netherlands, as those are the two countries Belgium is connected to. The sources of data used to calculate deliverable supply ensure publicly available figures consistent at the European level. Deliverable supply is calculated based on an average month of 30 days and delivery of power of 24h per day, so the MW capacity is transformed in MWh by multiplying by 720.

28. 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".

29. Based on the characteristics of the contract, ESMA considers it a reasonable approach not to have made any adjustements to the baseline.

Other months' position limits

30. The open interest was calculated as the daily average of open interest for the on venue contracts during the calendar year 2016. 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.

31. ESMA considers the upward adjustment made under Article 16 as appropriate to take into account the large number of separate expiries.

32. The other months' limit has been adjusted upwards to take into consideration the fact that the amount of open interest is 50% of deliverable supply. This is consistent with Article 18(3) of RTS 21.

33. As the result of the upward adjustments made to the baseline, the other months' limit is set at 40% of open interest.

34. 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

35. ESMA has found no evidence indicating that the proposed position limits are not consistent with the objectives established in Article 57(1) MiFID II.

36. 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.

37. 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 Belgian Power Baseload Futures contracts should be carefully monitored by the competent authority and that the limits should be reviewed on a timely basis.

VI. Conclusion

38. 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. 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, 15 April 2019

Steven Maijoor

Chair

For the Board of Supervisors