

OPINION on position limits on ICE Endex German Power Financial Base contracts

I. Introduction and legal basis

1. On 6 April 2020, the European Securities and Markets Authority (ESMA) received a notification from Netherlands Authority for the Financial Markets (AFM) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments¹ (“MiFID II”) regarding the exact position limits AFM intends to set for futures and options in German Power Financial Base 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 derivatives² (“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: base load (BSLD)

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

MIC: NDEX

Venue product code: GAB, DGB, GXC, GXQ, GX1, GX2, GX3

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, p. 84).

III. Market description

3. The ICE Endex German Power Financial Based Futures contract refers to the trading of electricity produced in Germany and received from the countries Germany is connected to. The contracts are traded in lots for which 1 lot equals 1 MW (1,000,000 Watts). The minimum trading size is 1 lot for electronic futures, 1 lot for Exchange for Physical (EFP) and 1 lot for exchange for swaps (EFS). There are monthly, quarterly and yearly future contracts available and the contracts are cash-settled. Months, quarters and years and years are listed in parallel.
4. The ICE Endex German Power Financial Based Options contract is an option on the German Power Financial Base Futures contract. At expiry, one lot of German Power Financial Base Options will exercise into one lot of German Power Financial Base Futures. German Power Financial Base Options are European-style, such that In-The-Money options, unless abandoned prior to expiry, are automatically exercised at expiry. The contracts are traded in lots for which 1 lot equals to 1 MW (1,000,000 Watts). The minimum trading size is 1 lot.
5. There is a high number of producers and their role in the market is very diverse. In Germany about 700 companies are holding a license to supply electricity to retail clients. Germany is currently in a process of fundamental market design changes ('Energiewende'). At the same time, more and more renewable energy generation facilities and new generation companies are entering the market. Germany's electrical grid is part of the Synchronous grid of Continental Europe.
6. In 2019, Germany produced 515,56 TWh of electricity of which 46.1% was from renewable energy sources, 29.1% from coal, and 10.5% from natural gas. While nuclear power production increased only slightly from 2018 (13.3%) to 2019 (13.8%), electricity generated from brown coal and hard coal significantly decreased by 22.3% and 32.8%, respectively. The electricity production from gas-fired power plants increased by 21.4% in 2019, due to the low gas prices. Germany will phase-out nuclear power by 2022, and as of 2019, coal is scheduled to be phased out by 2038. Germany, the largest exporter of electricity with 6% of the overall export saw in 2019 its export decreasing strongly, falling from 48 TWh in 2018 to about 30 TWh in 2019.

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

7. Deliverable supply amounts to 160,668,000 MWh.

8. Deliverable supply was calculated by the sum of the internal production and the cross-border net transmission capacity. For 2018, the internal production was 215,046 MW⁴ and the cross-border net transmission capacity amounted to 8,104 MW⁵.
9. Because deliverable supply is calculated 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, resulting in an estimation of deliverable supply of 160,668,000 MWh (223,150*720).

Spot month limit

10. Spot month limit amounts to 17,673,480 MWh, which represents 11% of deliverable supply. The spot limit applies to ICE Endex German Power Financial Base futures and options contracts. The spot month limit includes one monthly contract.

Spot month position limit rationale

11. The baseline for the spot month limit has been set at 25% as required by Article 9(1) of RTS 21.
12. The contract can have a position limit set between 5-50% as set out in Article 19(2)(a) and (b) of RTS 21 as the average number of market participants holding a position in the commodity derivative is lower than 10 and there are less than 3 investment firm acting as a market maker in accordance with Article 4(1)(7) of Directive 2014/65/EU.
13. The AFM has considered the following factor for adjusting the spot month limit downwards from the baseline:
 - Article 18(3) of RTS 21: The deliverable supply is significantly higher than the open interest. Based on the rationale of Article 18(3) of RTS 21, the AFM has applied a reverse interpretation of Article 18(3) of RTS 21 and adjusted the spot month limit downwards.
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. Given the characteristics of this contract, the AFM decided to set a spot month limit of 11% of deliverable supply. This provides a figure of 17,673,480 MWh.

Other months' position limit

⁴ https://docstore.entsoe.eu/Documents/Publications/Statistics/Factsheet/entsoe_sfs2018_web.pdf

⁵ <https://transparency.entsoe.eu/transmission-domain/ntcYear/show>



Open interest

16. Open interest amounts to 9,177,483 MWh. There are overlapping contracts for the ICE Endex German Power Financial Base market. The overlapping contracts are identified based on the contract specifications. To be aggregated, the contracts must have identical settlement and delivery terms for the same hub. As a consequence, related contracts with cash settlement and physical settlement cannot be aggregated and therefore have their daily open interest calculated separately. For the ICE Endex German Power Financial Base market, there are 8 related contracts that fit the aggregation criteria of identical settlement and delivery terms. The contracts for this Other Months limit are:

- German Power Financial Base Futures (GAB)
- German Power Financial Base Options (GAB)
- German Power Financial Base Daily Futures (DGB)
- German Power Financial Base 1x Call Options (GXC)
- German Power Financial Base 1x Qtr Options (GXQ)
- German Power Financial Base Early (Q1) 1x Cal Options (GX1)
- German Power Financial Base Early (Q2) 1x Cal Options (GX2)
- German Power Financial Base Early (Q3) 1x Cal Options (GX3)

17. The daily average open interest was calculated by adding the open interest from each identified related contract that can be aggregated. The daily average open interest figures are extracted from the AFM position reporting system. The resulting figure is the daily open interest of the relevant contract for the selected publication date. A daily overview of the contract open interest was made by repeating this process for each publication date for February 2020. Then an average was calculated resulting in the February 2020 daily open interest figure. Positions in options have been delta-adjusted.

18. Using the definitions as detailed in RTS 21 and the ESMA Questions and Answers on MiFID II and MiFIR commodity derivatives topics, the aggregated daily open interest average over February 2020 period for the German Power Financial Base is 9,177,483 MWh. The ICE Endex German Power Financial Base market is rapidly developing from an illiquid market to a less illiquid market. The daily average open interest has developed over the year 2019 as follows (in MWh): 2,873,141 in Q1, 4,430,174 in Q2, 5,486,060 in Q3 and 6,854,359 in Q4. The daily average open interest reached 9,177,483 MWh in February 2020, representing a significant increase of 348% in open interest compared to February 2019. This is a significant change on the market, based on the open interest (Article 57 (4) MiFID II). Therefore, in addition to the yearly daily average of open interest, the open interest development trend



should be taken in consideration for classifying the market under the position limits regime and identifying the appropriate derogations.

Other month's position limit

19. The other months' limit amounts to 4,588,742 MWh. The other month's limit applies to ICE Endex German Power Financial Base futures and options contracts. It includes monthly, quarterly and yearly contracts.

Other months' position limit rationale

20. Considering the above-mentioned market developments, the fact that there are no investment firms active as market makers on the ICE Endex German Power Financial Base market, a 25 percent base line limit should be applied, whereby Article 19(2)(b) of RTS 21 provides an extension of the upper limit from 40% to 50%.

21. AFM has considered the following factors to adjust the other month's position limit upwards:

- Article 16(2) of RTS 21: The ICE Endex German Power Financial Base has a relatively large amount (59 consecutive months) of separate expiries in the Other Months contracts. Therefore, the limit shall be adjusted upwards.
- Article 18(3) of RTS 21: In 2019, the highest daily OI in 2019 in the German Power Financial Base market was significantly lower (< 6%) than the relevant deliverable supply. Therefore, the limit shall be adjusted upwards.

22. In considering the volatility in the contracts, 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.

23. All other factors have been considered and were not regarded as material or relevant to require additional adjustments, either up or down, from the baseline.

24. Given the characteristics of this contract, the AFM has decided to set a total upward adjustment of 25 percentage points resulted in an adjusted baseline of 50% of open interest. This provides another months' position limit of 4,588,742 MWh.

V. ESMA's Assessment

25. This Opinion concerns positions held in ICE Endex German Power Financial Base contracts.

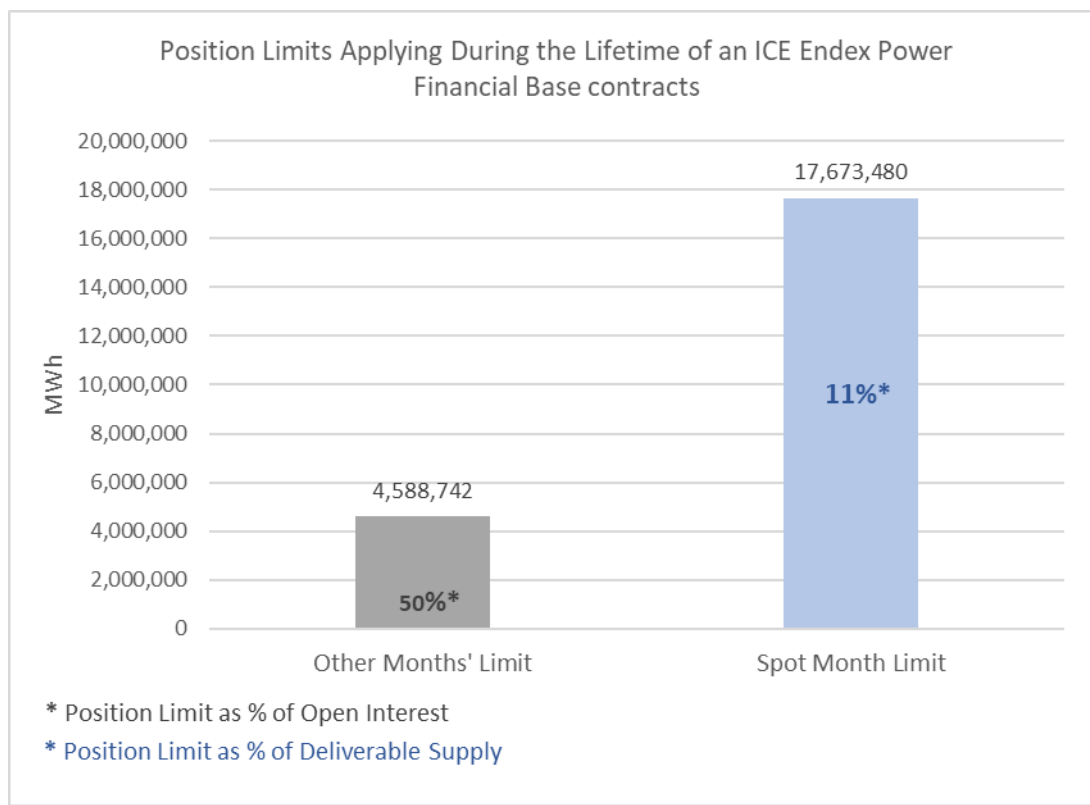
26. ESMA has performed the assessment based on the information provided by AFM.

27. ESMA notes that the ICE Endex German Power Financial Base futures and options contract is a recently liquid contract for which bespoke position limits are established by the AFM for the first time.

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.

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

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



Spot month position limit

30. The calculation of the deliverable supply is based on of the internal production and the cross-border net transmission capacity for the year 2018. The source of data used to calculate deliverable supply (ENTSO-e statistics) ensures publicly available figures that are consistent at the European level.

31. 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.”

32. The monthly deliverable supply figure has been calculated by converting the capacity (expressed in MW) to MWh per month.
33. 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”.
34. Compared with the baseline figure of 25% of deliverable supply, the spot month position limit has been adjusted downwards and set at 11% of deliverable supply.
35. ESMA considers that, since the deliverable supply (160,668,000 MWh) is significantly larger than the open interest (9,177,483 MWh), 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.
36. Taking into account all of the above, ESMA considers reasonable to adjust the spot month limit downwards.

Other months’ position limit

37. The daily average open interest was calculated by adding the open interest from each identified related contract that can be aggregated. The daily average open interest figures are extracted from the AFM position reporting system. The resulting figure is the daily open interest of the relevant contract for the selected publication date. A daily overview of the contract open interest was made by repeating this process for each publication date for February 2020. Then an average was calculated resulting in the February 2020 daily open interest figure. Positions in options have been delta-adjusted.
38. ESMA considers such an approach sensible because of the recent evolution of the open interest which has been constantly rising.
39. Compared to the baseline figure of 25% of overall open interest, the other months’ position limit has been adjusted upward and set at 50% of open interest.
40. 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 fact that the ICE Endex German Power Financial Base contract has a large number of separate expiries (Article 16(2) of RTS 21).



41. 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

42. 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.

43. With respect to the spot month limit, ESMA notes that, based on the information provided by the competent authority, that the limit is substantially higher than the open interest in the spot month during the reference period of 1-29 February 2020 and even than the overall open interest during that same period.

44. 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. ESMA also notes that the ICE Endex German Power Financial Base contract is a recently liquid contract where the size of open interest sharply contrasts with the size of deliverable supply. 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.

45. In light of the assessment above, ESMA considers that the position limits 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 ICE Endex German Power Financial Base contracts are not hampered.

46. 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 the ICE Endex German Power Financial Base contracts should be carefully monitored by the competent authority, in particular during the spot month, and that this spot month limit should be reviewed on a timely basis.

VI. Conclusion

47. 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. This 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.

48. This Opinion is published on the ESMA's website.

Done at Paris,



Steven Maijoor

ESMA Chair