European Securities and Markets Authority

Date: 2nd December 2020
ESMA70-155-11233

OPINION on position limits on EEX Phelix DE/AT 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 instruments[1] ("MiFID II") regarding the exact position limits the BaFin intends to set for the Phelix DE/AT 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 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.

3. On 24 September 2018, ESMA issued a first opinion regarding the exact position limits BaFin intended to set for the Phelix DE/AT Base Power futures and options commodity contracts. The position limits considered by BaFin in August 2017 was 46,000,381 MWh for the spot month limit and 825,477,708 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 in deliverable supply or open interest, or any other significant change on the market, and reset the position limit. Since the contract has been replaced by a new contract type, no new OI can be created which leads to decreasing with time overall OI. In addition, whereas the open interest underpinning the position limits set out in BaFin's initial

[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).

submission had been calculated based on the information provided by the trading venue, BaFin has now calculated again the open interest based on position reporting data. Consequently, BaFin considered that since there had been a significant decrease in the open interest compared to its initial submission, the position limit had to be reset for both the spot month limit and the other months' limit. ESMA understands that the new position limits will apply after the date of the issuance of ESMA opinion on those revised position limits. The new limits are replacing the previous position limits as determined by BaFin from the date of their application.

5. In the opinion herewith, ESMA is assessing whether the new position limits BaFin has set for the EEX Phelix DE/AT 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: F1B, O1B

III.Market description

6. 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, e.g. due to heating demand in winter or air-conditioning in summer. However, such seasonal effects are rather small.

7. Since the electricity system constitutes critical infrastructure, power markets in Germany and Austria are subject to close surveillance of national and European regulators, including supervision for the purpose of the prevention of abusive practices of dominant positions. Similar to financial markets, REMIT prohibits market manipulation of the spot market.

8. There is a high number of producers and their role in the market is very diverse. In Germany, the 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 report, the Federal Cartel Office found that there is currently no dominant power generating company[4]. However, the situation could change in the future as a result of the phase-outs of nuclear and coal power.

9. The Phelix DE/AT Power Futures and Options contracts are cash settled derivatives contracts referring to the average power spot market prices of future delivery periods of the German/Austrian market area. The underlying of these contracts is the Physical Electricity Index determined by EPEX Spot Exchange on a daily basis. Trading participants have the option of arranging physical delivery on the spot market for monthly and weekly contracts.

10. Those contracts used to be the most important and highest-selling contracts at EEX. However, since 1 October 2018 the common German-Austrian market area has been split into national market areas. As a consequence, the corresponding contract types have been replaced by stand-alone contracts for the German market area and for the Austrian market area. Therefore, the open interest of the Phelix DE/AT is composed of positions entered into before the split of market areas. Meanwhile, new business does not take place anymore so that this contract type is fading out.

11. Maturities in the Phelix DE/AT Base power futures include day, week, weekend, month, quarter and year contracts, with the furthest maturity traded of 6 years. The relevant option contracts when exercised are booked into the corresponding futures position.

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

12. Deliverable supply amounts to 181,002,466 MWh.

13. 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 and Austria for the year 2018 and the average yearly import capacities of these countries for 2020. These values of 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 time frame of one calendar month for the spot month period.

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

Spot month position limit

14. The spot month limit is set at 9,050,124 MWh, which represents 5% of the deliverable supply. The spot month limit applies to Phelix Base DE/AT futures and options contracts. It includes daily contracts, weekend contracts, weekly contracts and monthly contracts.

Spot month position limit rationale

15. As the daily average open interest in 2020 is above 20,000 lots, European Energy Exchange Phelix Base AT/DE Power is classified as a 'liquid' contract with a baseline limit of 25%. The baseline figure therefore was calculated as 25% of the deliverable supply, i.e. 25% * 181,002,466 MWh = 45,250,617 MWh.

16. From the baseline, BaFin considered the following factors relevant for adjusting the limit downwards:

- BaFin made a downwards adjustment under Article 18(3) of RTS 21 since the deliverable supply is significantly higher than the open interest, and

- Additional downward adjustment has been made under Article 17 of RTS 21 since the deliverable supply is also used for other commodity contracts in the EU, for instance for contracts at ICE Endex.

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

18. Based on the above, BaFin decreased the spot month limit by 20 percentage points over the baseline, which results in a spot month limit of 9,050,124 MWh representing 5% of the deliverable supply.

Other months' position limit

Open interest

19. Open interest amounts to 12,973,631 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

20. The other months' limit amounts to 4,540,085 MWh, which represents 35% of open interest. The other months' limit applies to Phelix Base DE/AT futures and options contracts.

Other months' position limit rationale

21. The baseline figure for the other months' limit amounts to 25% of open interest, i.e. 3,243,408 MWh, as required by Article 11(1) of RTS 21.

22. BaFin considered the following factors relevant for adjusting the baseline upwards:

- An upwards adjustment has been made under the Article 16(2) due to large number of separate expiries (10 monthly contracts, 11 quarterly contracts and 6 yearly contracts), and

- Under Article 18(3) because the overall open interest is significantly lower than the deliverable supply.

23. 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, 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.

24. Given the characteristics of this contract, BaFin adjusted the limit upwards by 10 percentage points from the baseline. This results in a limit of 4,540,085 MWh representing 35% of the open interest.

V. ESMA's Assessment

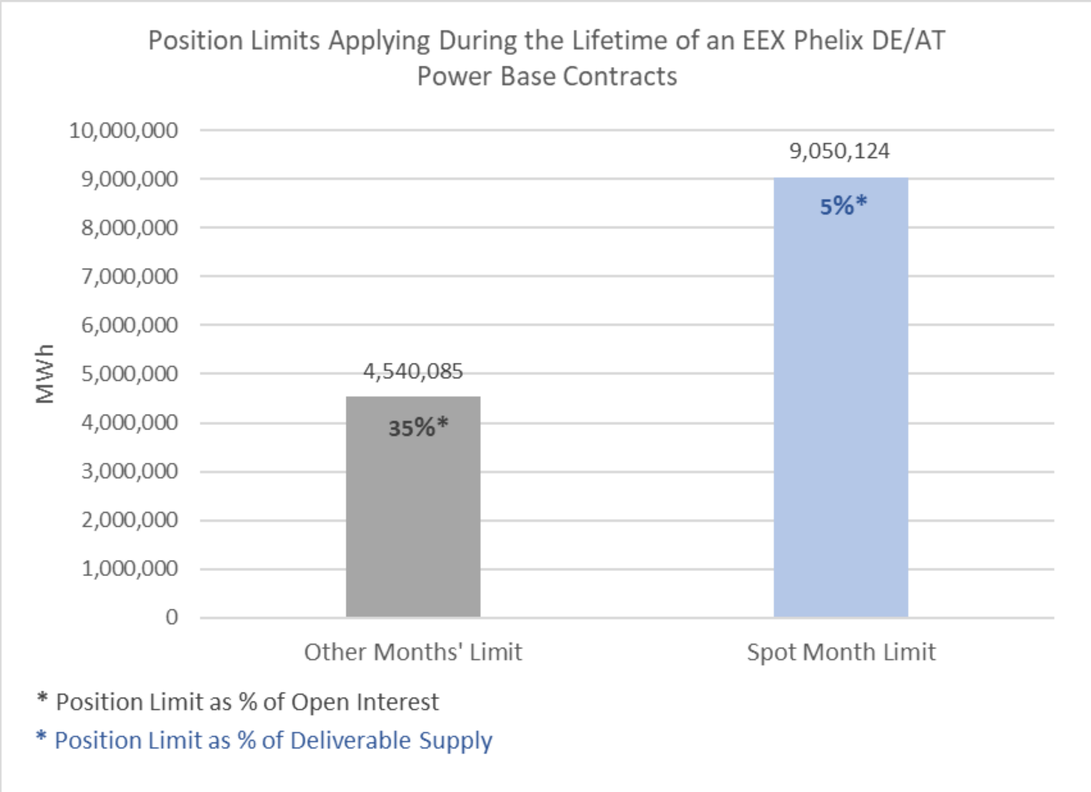
25. This opinion concerns positions held in the Phelix DE/AT base power contracts.

26. ESMA has performed the assessment based on the information provided by the 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 whole spot month and another limit for the other months.



<u>Spot month position limit</u>

29. The calculation of the deliverable supply is based on ENTSO-e figures. ESMA agrees with using data from ENTSO-e to calculate deliverable supply, as this ensures publicly available figures consistent at the European level.

30. ESMA also agrees with the methodology used to include both domestic generation plus imports into Austria and Germany, as 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”.

31. Whilst the physical delivery of power depends on the actual days of the month, ESMA 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.

32. ESMA considers as a reasonable approach to have adjusted the spot month limit downwards under Article 17 of RTS 21, since the deliverable supply can be used for the other power contracts sharing the same underlying and under Article 18(3) of RTS 21, since the deliverable supply significantly exceeds the overall open interest.

Other months' position limit

33. 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 and considers such approach consistent with Article 12 of RTS 21.

34. Regarding the other month's position limit, ESMA considers it is a reasonable approach to have made upward adjustments: i) based on the large number of separate expiries, in accordance with Article 16(2) of RTS 21 and ii) based on the fact that the open interest is significantly lower than the deliverable supply, in accordance with Article 18(3) of RTS 21; and

35. 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

36. 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.

37. With respect to the spot month limit and based on the information provided by the competent authority, ESMA notes that the limit is substantially higher than the open interest in the spot month throughout 2020. Where the limit set for the spot month is well above the positions held by market participants in the spot month, there is a risk that the objectives set out in Article 57(1) of MiFID II may not be achieved. However, ESMA also notes that BaFin has set the spot month limit at the lowest possible level of 5% of the deliverable supply in accordance with Article 14 of RTS 21 and that no further downward adjustment was possible under the methodology established in RTS 21.

38. 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/AT Base Power contracts are not hampered.

39. 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 Phelix DE/AT Base Power contract should be carefully monitored by the competent authority, in particular during the spot month.

VI. Conclusion

40. 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. The other months' position limit does also comply 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

Steven Maijoor

Chair

For the Board of Supervisors