

OPINION on position limits on OMIP SPEL Base contracts

I. Introduction and legal basis

1. On 30 June 2017, the European Securities and Markets Authority (“ESMA”) received a notification from the Comissão do Mercado de Valores Mobiliários (“CMVM”) under Article 57(5) of Directive 2014/65/EU on markets in financial instruments¹ (“MiFID II”) regarding the exact position limits the CMVM intends to set for the OMIP SPEL (Spanish zone) Base 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 derivatives² (“RTS 21”) and taking into account the factors referred to in Article 57(3) of MiFID II. Additional information was received on 4 October 2019.
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: MERCADO DE DERIVADOS OMIP (OMIP DERIVATIVES MARKET)

MIC: OMIP

Venue product code: FTB

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. On 1 October 2004, Portugal and Spain signed an agreement in Santiago de Compostela for the creation of the Iberian Electricity Market (Mercado Ibérico da Energia Eléctrica, MIBEL). This agreement defined the basis of a future, single and integrated power market for Iberia. MIBEL was defined by a set of organised (both the spot and the derivative markets) and non-organised markets where business is conducted in a bilateral basis (OTC).
4. The initial organisation of MIBEL was defined as follows:
 - i. Derivatives Market: based in Portugal and managed by (OMIP)⁴. OMICLEAR has been, since the start, the central counterparty to all transactions executed and registered on derivative contracts available on the OMIP Derivatives Market;
 - ii. Spot Market (day and intraday): based in Spain and managed by OMIE⁵.
5. The MIBEL Council of Regulators (CR MIBEL) was created to supervise and follow the development of MIBEL with representatives of the competent authorities (“CA”) of both Portugal and Spain responsible for supervising the market and the financial instruments and for supervising the electricity sector:
 - i. Portugal: CMVM and ERSE (Portuguese Energy Services Regulatory Authority); and
 - ii. Spain: CNMV and CNMC (Spanish National Commission on Markets and Competition).
6. The supervision of MIBEL is performed in a coordinated form by the CR MIBEL without prejudice to the specific competences of each CA.
7. The electricity market of MIBEL, as well as the electricity market on the European Union, lies on two basic foundations:
 - i. The strong regulation of this sector (well detailed legal and regulatory framework with specific competences given to the assigned CAs);
 - ii. Electricity cannot be stored, which is one of the main constraints on this type of commodity, which also affects its commodity derivatives market.
8. The transportation of the electricity is made through a network system (energy flux), where the Transmission System Operator (TSOs) assumes the dominant role. The European market is strongly interconnected through the Multi-Regional Coupling.

⁴ Operador do Mercado Ibérico de Energia (Pólo Português, S.G.M.R., S.A.)

⁵ Operador do Mercado Ibérico de Energia (Polo Español S.A.)

9. In Iberia, OMIE is responsible for the management of the spot market (day and intraday markets), and responsible for the cash delivery as well as the management and potential execution of guarantees in place for the fulfilment of the clients' obligations.
10. OMIE is regulated and subject to the rules of the electricity sector in Spain and the respective European regulation in place.
11. In compliance with the current legislation, all bids and offers on electricity must be submitted into the spot trading platform (those arisen from bilateral agreement, those of the Derivatives Market managed by OMIP or OTC with physical delivery). Only entities that have the ability to physically buy or sell electricity (e.g. are able to acquire or inject electricity into the grid) can trade on the spot market.
12. The access to the market is done through a trading platform via internet, which enables the simultaneous participation of a high number of agents as well as the management of a big volume of bid and offers on electricity on a short period of time. Through this platform, the buyers and sellers acquire the volume they need (MWh) at public and transparent prices. The positions arisen from the derivatives market managed by OMIP with physical delivery are submitted into this platform and then become subject to the rules of this market.
13. On the spot market, it is possible to trade: bilaterally, day-ahead and intraday. In June 2017, the spot market was offering daily products for the next day plus six intraday sessions, where it is possible to re-trade positions previously assumed with high liquidity. In 2015, the activity on the Portuguese spot market represented 71% of the total demand of electricity and the activity on the Portuguese spot market represented 63% of the total demand of electricity.
14. As this commodity, cannot be stored (at least in considerable amounts), meaning that it must be used at the production time, the electricity supply is done via the physical delivery model. This model consists of fluxes between its origin (centers where the energy is produced) and the consumers, under the coordination of the TSOs. In Iberia, the responsibility for physical delivery lies with REN6 and REE7 (the respective national grid operators of Portugal and Spain). They receive the provisional programs from all agents (directly or via the spot market) and upon validation assume the responsibility of receiving the energy from the producers and auctioning delivery to the consumers and must ascertain, appraise and settle all deviations to the program previously communicated.
15. There are two types of restrictions regarding the underlying market that can be identified:
 - i. Production restrictions: can have its origin in malfunctions or equipment maintenance of the centres where the energy is produced, or a fail into the provisioning of the primary energy (fuel, water, wind, solar radiation).

⁶ Redes Energéticas Nacionais

⁷ Red Eléctrica de España

The existing reserves in Portugal and Spain as well as its monitoring at a national level by the respective entities allows to conclude that any production restriction may be overcome using alternative means.

- ii. Transportation restrictions: this situation is similar to the production as the networks that give support to the market are planned and executed with redundancy criteria, which allows the reduction of the impact to a minimum level when an element gets withdrawn due to an accident.
16. The production of electricity is heavily linked to seasonality elements due to the mix of production in the Iberian zone, where the hydroelectric and wind power have a considerable share in the production of electricity in both countries (the technological power structure in place is very similar in Portugal and Spain). In Spain, in the year of 2016, the structure was 38,9% fossil (coal and natural gas), 24,8% renewable energy, 21,4% nuclear and 14,9% hydroelectric power. In Portugal: 42,2% fossil, 29,8% hydroelectric power and 28% renewable energy. The seasonality influences the prices and its fluctuations.
17. The following instruments are listed in what concerns to SPEL Base underlying:
 - i. The OMIP SPEL Base future contracts, reference price on the Spanish zone (SPEL). These contracts are cash and physically settled, or cash settled only. OMIP lists the following two contracts with SPEL Base Load as underlying:
 - a. OMIP SPEL Base Physical Futures Contracts (physically and cash settled) and
 - b. OMIP SPEL Base Financial Futures Contracts (cash settled only).
 - ii. OMIP makes available a wide range of maturities, from daily up to annual (day, weekend, weekly, monthly, quarterly and annual), with delivery periods that include the 24 hours on all weekdays: Monday to Sunday (Baseload).
 - iii. Option contracts on OMIP SPEL Base futures, delivering into OMIP SPEL Base financial futures contract, with monthly, quarterly, and annual maturities are available. There has been no open interest in options between 2015 and the first quarter of 2017.
18. It is also possible to register bilateral transactions (OTC) in the OMIP trading platform with a registration in OMICLEAR for all contracts listed on OMIP and tradable in a continuous or auction mode, as well as the following contracts:
 - i. Forward contracts with physical delivery, with the reference price of the Spanish zone (SPEL); and
 - ii. Swap contracts with only cash delivery on SPEL.
19. All contracts are subject to a cash delivery that is processed through OMICLEAR. Whenever a contract is also subject to physical delivery, OMICLEAR calculates the balance of the final positions to deliver in the Spanish zone in relation to the transactions booked in each Physical registration account and determines the net value (buyer/seller) of electricity.

OMICLEAR makes this information available to the Physical Settlement Agents and communicates to OMIE the net balance so it can be integrated into the spot market as an order.

20. After introducing the orders in the spot market, the orders become subject to the rules of this market (spot market – OMIE). To be noted that neither the Clearing Members of OMICLEAR nor OMICLEAR are responsible for the physical delivery of the positions as this subject is ruled by the rules of OMIE (the physical settlement agents are responsible for guarantying the delivery).
21. The most traded maturities in the market for SPEL Base are the monthly and quarterly (average weight on the past 4 years (2013 to 2016) 34% and 27% respectively, while the other maturities have lower representation (weeks: 24%, days: 12% and years: 3%).
22. The registration of OTC for SPEL Base in OMIP is different; the maturities where the bulk of registrations happen are the dailies (55%), monthlies (16%) and quarterlies (13%).
23. The weight of the OTC of the electricity derivatives market in Iberia (Spanish and Portuguese electricity) is quite high with percentages above 80% (analysis conducted between 2010 (91%) and 2015 (82%)). The trading of electricity derivatives on OMIP represents only 13% of the overall trading of electricity derivatives in Iberia (period of analysis: 2010 to 2015).
24. As per the data of OMIP (in relation to the daily price variation limits that apply) the volatility of the derivative contracts at OMIP Market are low: (i). Day: 7.6% (ii). Year 1 – Year 4: 1.2% - 0.8% and slightly higher for short maturities.
25. There are less than three investment firms acting as market makers.

IV. Proposed limit and rationale

Spot month position limit

Deliverable supply

26. Deliverable supply amounts to 80,089,930 MWh.
27. The Spanish electricity physical market is part of the Iberian Electricity Market (MIBEL); therefore, the net figure for the total Delivery Supply volume is achieved by adding Spain's own self-electricity generation capacity to its import capacity.
28. The Net Generating Capacity (in MW) in 2017 for Spain was 105,429 MW⁸. The quantity of the power that can be used to fulfil delivery requirements of the Spanish power contracts

⁸ <https://transparency.entsoe.eu/generation/r2/installedGenerationCapacityAggregation/show>

should also take into account the import capacity that Spain can obtain from both France and Portugal, which amounts up to 4,289 MW, coming up to a total Deliverable Supply of 109,718 MW

29. As the Delivery Supply is to be calculated in MWh, this figure has been converted from MW to MWh per year. The overall value was then divided by the factor of 12 in order to align the deliverable supply to the time frame of one calendar month for the spot month period, which result in a Deliverable Supply of 80,089,930 MWh.

Spot month position limit

30. The spot month limit is 20,022,483 MWh, which represents 25% of deliverable supply. The position limit applies to the OMIP SPEL Baseload Financial Futures and Options contract and to the OMIP SPEL Baseload Physical Futures and Options contract.

Spot month position limit rationale

31. According to Article 15 of RTS 21, as the daily average open interest in 2016 is above 14,411,408 MWh (20,000 lots), the contract is classified as a 'regular' or 'liquid' market with a baseline limit of 25% and a standard range of the limit between 5% and 35%.
32. All factors have been considered by CMVM and have not been regarded as material or relevant to require any 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 CMVM has not found evidence that this is excessive or that lower position limits would reduce volatility.
33. Based on the above, CMVM has decided to set a position limit at the baseline of 25% of deliverable supply. i.e. to 20,082,483 MWh.

Other months' position limit

Open interest

34. The open interest amounts to 14,411,408 MWh.
35. Open interest has been calculated considering each individual holder, at trading account level, for the following dates: 31/01/2017, 28/02/2017 and 31/03/2017. The daily average has been calculated considering the buy and sell positions on a gross basis. All contracts whose underlying is the OMIP SPEL Base electricity and mature in the same date have been aggregated, for each individual holder, in units of underlying MWh. The open positions in Futures contracts resulting from transactions executed in the Trading Platform (continuous and auction) of the Derivatives Market of OMIP and from OTC transactions registered in

⁹ <https://transparency.entsoe.eu/transmission-domain/htcYear/show>

OMIP were considered. There has been no open interest in OMIP SPEL Base options between 2015 and the first quarter of 2017.

36. Considering that futures contracts on SPEL Base are cash and physically settled or cash settled only, according to the nature of the trading account where the open position is registered at the last trading day, both cash and physical contracts are considered to achieve the open interest in the OMIP SPEL Base contracts.

Other months' position limit

37. The other months' position limit is set at 5,043,993 MWh, which represents 35% of open interest. The position limit applies to the OMIP SPEL Baseload Financial Futures and Options contract and to the OMIP SPEL Baseload Physical Futures and Options contract.

Other months' position limit rationale

38. CMVM has considered the following factors considered relevant for adjusting the baseline upwards:

- Article 16(2) of RTS 21: There is a large number of separate expiries (28 separate expiries on average depending on the trading date selected).
- Article 18(3) of RTS 21: The overall open interest (14,411,408 MWh) is significantly lower than the deliverable supply (80,089,930 MWh).

39. All the other potential adjustment factors set out in RTS 21 have been considered by CMVM 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 CMVM has not found evidence that this is excessive or that lower position limits would reduce volatility.

40. Based on the above, CMVM has decided to make a total upward adjustment of 10 percentage points to the baseline and to set the other months' limit at 35% of open interest, i.e. at 5,043,993 MWh.

V. ESMA's Assessment

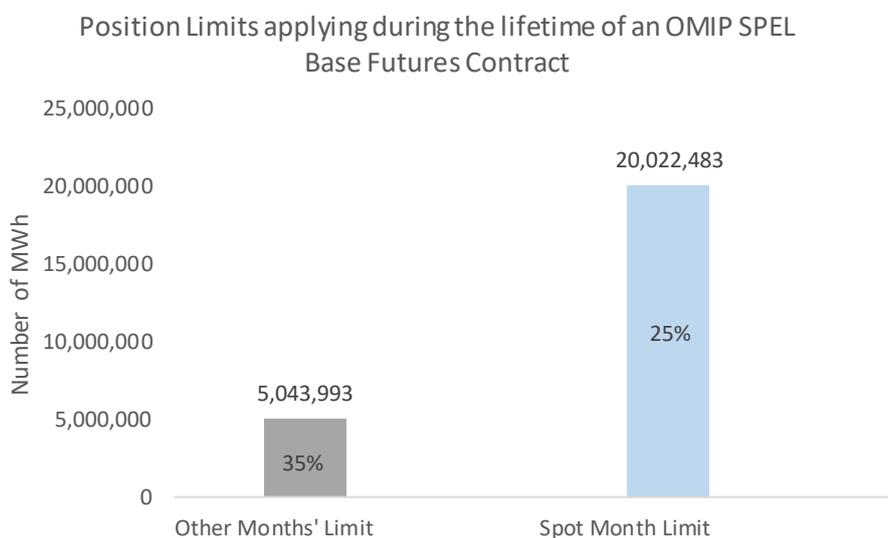
41. This Opinion concerns positions held in OMIP SPEL Baseload Futures and Options contracts.

42. 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.

43. When performing this assessment, ESMA also took into account the need to ensure that the methodology set out in RTS 21 promotes a consistent application of position limits across competent authorities including when commodity derivatives are based on the same underlying such as Spanish power in this case.

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

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



Spot month position limit

45. The deliverable supply was estimated based on ENTSO-E (European Network of Transmission System Operators for Electricity) data. It is composed of the average Spanish domestic Net Generating Capacity (NGC) and Spanish yearly import capacity for the year 2017. ESMA agrees with using data from ENTSO-E data to calculate deliverable supply as this ensures publicly available figures consistent at the European level.

46. ESMA considers that the methodology used 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.”

47. The monthly deliverable supply figure has been calculated by converting the capacity (expressed in MW) to MWh per month.
48. 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”.
49. 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.
50. ESMA notes that, when setting the spot month limit, the CMVM did not consider any adjustment factor relevant and did not make any adjustment to the baseline.

Other months' position limit

51. Under Article 11 of RTS 21, competent authorities shall determine a baseline figure for the other months' position limit in a commodity derivative by calculating 25% of the open interest in that commodity derivative.
52. ESMA considers it a reasonable approach to have adjusted the other months' limit upwards under Article 16(2) of RTS 21 due to the large number of separate expiries.
53. The other months' limit has been adjusted upwards to take into consideration the fact that the amount of open interest is significantly lower than the deliverable supply. ESMA considers that such adjustment is consistent with Article 18(3) of RTS 21.
54. Overall, those position limits have been set following the methodology established by RTS 21.

Compatibility with the objectives of Article 57(1) of MiFID II

55. 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.
56. ESMA notes that the position limit set by CMVM for the spot month amounts to 20,082,483 MWh. Based on the information provided by the CMVM, such limit significantly exceeds the spot month open interest in SPEL Base contracts, which amounts to 1,200,304 MWh on average on the three dates considered to calculate the overall open interest. Furthermore, the spot month limit exceeds the overall open interest in the OMIP SPEL Baseload contracts which amounts to 14,411,408 MWh.

57. Position limits calculated on the basis of the methodology under RTS 21 have to be compatible with the objectives set out in Article 57(1) of MiFID. When the limit set for the spot month in a commodity derivative is well above the overall positions held by market participants in that commodity derivative, such spot month limit would be deprived of any potential effect and as such would not ensure the achievement of those objectives.
58. As clarified by Recital 13 of RTS 21, “[...] Competent authorities should ensure that an adjustment downwards of the baseline is effected whenever it is necessary to prevent dominant positions and to support orderly pricing in the commodity derivative and the underlying commodity [...]”. ESMA however notes that CMVM did not take any step towards addressing this risk that the objectives set out in Article 57(1) of MiFID II may not be achieved by considering all the potential downwards adjustment factors to the spot month limit baseline available under RTS 21.
59. To ensure that the spot month limit resulting from the application of the methodology under RTS 21 also contributes to the fulfilment of the objectives set out in Article 57(1) of MiFID II, ESMA is of the view that the CMVM should have further considered adjusting the spot month limit downwards based on the adjustment factors available under RTS 21.
60. ESMA notes in particular that when open interest is significantly lower than deliverable supply, Article 18(3) of RTS 21 provides that the other months’ limit should be adjusted upwards. ESMA considers that the rationale underpinning Article 18(3) of RTS 21 with respect to the other months’ enables the national competent authority to adjust the spot month limit downwards in case the open interest is significantly lower than deliverable supply.
61. Otherwise, the application of RTS 21 would lead to a situation where the position limit is relatively constrained in the other months’ while market participants would be granted permission for a large increase of their position once the contract enters the spot month and is nearing expiry. Permitting to take a much larger position the closer a contract gets to expiry would not contribute to the achievement of the objective of preventing market abuse and supporting orderly pricing and settlement conditions.
62. ESMA notes that the overall open interest in the OMIP SPEL Baseload contracts (14,411,408 MWh) is significantly below the deliverable supply (80,089,930 MWh). As a consequence, CMVM could have adjusted the spot month position limit downwards in light of the rationale explained above.
63. ESMA further notes that for the two other commodity derivatives based on Spanish power, the EEX Spanish Power Base load Futures contract and the MEF Spanish Power Base load Futures contract, the spot month limit baseline has indeed been adjusted downwards based on such rationale due to the open interest being significantly lower than the deliverable supply.
64. As clarified by Recital (1) of RTS 21, “The methodology should prevent regulatory arbitrage and promote consistency [...]”. ESMA is concerned that departing approaches to



applying position limits that are not justified by variations among different commodity derivatives markets and the markets in the underlying commodity would undermine consistency and harmonization in the application of position limits to derivative contracts based on Spanish power and would be a source of an unlevel level field across trading venues. In the specific context of the SPEL Baseload contract spot month limit, ESMA notes that no explanations were provided by CMVM regarding the characteristics of that commodity derivative market or of the underlying commodity that would justify the separate approach taken for setting such spot month limit.

VI. Conclusion

65. Based on all the considerations and analysis presented above, it is ESMA's opinion that the spot month position limit set for the OMIP SPEL Base contract is not consistent with the objectives of Article 57(1) of MiFID II.
66. According to Article 57(5) of MiFID II, CMVM shall modify the spot month position limit in accordance with ESMA's opinion or provide ESMA with a justification why the change is considered to be unnecessary. Where CMVM imposes a limit contrary to an ESMA opinion, it shall immediately publish on its website a notice fully explaining its reasons for doing so.

Done at Paris,

Steven Maijoor

Chair

For the Board of Supervisors