Amstelveenseweg 998
1081 JS Amsterdam

Phone: + 31 20 520 7970
Fax: + 31 346 283 258

Email: secretariat@efet.org
Website: www.efet.org

ABN Amro Bank Amstelveen:
Account no: 54 05 15 116

EFET Response to

ERGEG draft advice on the regulatory oversight of energy exchanges

An ERGEG Public Consultation Document

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European Federation of Energy Traders (EFET)[1]

EFET Task Force Market Supervision

Overall EFET view

Executive Summary

EFET welcomes the ERGEG initiative to examine the potential for harmonization and enhancement of regulatory oversight of energy exchanges ("EXs"), which in the context of the present draft advice are believed to be limited to those dealing with gas and electricity.

EFET believes, however, energy exchanges in Europe don't need uniform/ EU level supervision beyond what is already provided for in national law and MiFID/ EMIR, or what will be provided for in REMIT.

We believe that the ERGEG analysis of a more harmonised approach to market oversight and a more uniform supervision of exchange functions (at least as far as physical power and gas transactions are concerned) should contribute to elaboration of part of the implementing measures under an energy wholesale market integrity and transparency regulation (REMIT). It could also support the alignment of national practice with regard to oversight of exchanges, with a view to improving further the proper supervision of wholesale power and gas markets in Europe.

Moreover, the work programmes set according to the Third IEM Legislative Package already set a course for the sufficient harmonisation of wholesale market models for the power and gas sectors respectively. We do not see a need additionally to force the introduction of identical exchange or trading rules in every country.

Harmonisation of EXs rules can be driven by market needs

EXs differ in terms of level of liquidity, as mentioned in the consultation paper: in our experience the applicable market design and regulatory framework (e.g. congestion management rules, number of market participants, balancing agreements rules) have much more influence on market development than EXs' rules or the EX oversight regime.

In principle we do favour harmonised exchange participation arrangements (e.g. IT standards, settlement rules, payment periods, margin requirements) but believe that an

[1] The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information, please refer to: www.efet.org

alignment process can be driven by market participants, exchange management competitive initiatives, according to market requirements. It does not need, therefore, to be introduced through a specific regulatory framework and should adapt to market evolutions. The most appropriate manner is through the voluntary involvement of market participants in the elaboration of exchange rules.

This EFET conclusion presupposes that the specific capacity allocation services performed by exchanges on behalf of TSOs such as electricity market coupling arrangements (e.g. the single algorithm of the Price Coupling of Regions- PCR project) are being covered by separate governance guidelines under preparation by the European Commission, as foreseen in the Regulation EC/715/2009.

Preserving a choice of trading platforms for market participants

We agree with the ERGEG opinion that oversight of EXs differs in EU Member States due to differing national legislation. The differentiation of EXs is very extensive and is not limited to oversight but also to their ownership, structure, organization, nature/origin, functioning, products offered and several other factors. It is therefore difficult to identify the best practices in all these aspects.

The diversified structure of EXs is *per se* not an issue. Energy exchanges should be subject to tighter governance rules when they enjoy special market privileges of a monopolisic or oligopolistic nature; correspondingly market participants deserve a continuing choice of trading venue wherever feasible; so European institutions should look into legitimacy in a liberalised market of the monopoly functions, which already are granted to exchanges in some Member States.

Although it is not the subject of the consultation, there are two interlinked aspects, to which we would like to draw attention:

- In some Member States EXs are mandated to run a power spot and/or futures market by law, and there is an increasing tendency to appoint the domestic power exchange to become also responsible for the gas market. We believe that results of such an approach are suboptimal, compared with the benefits of a competitive environment between trading platforms. Where a monopoly exchange has been appointed, some oversight will be necessary to ensure that a proper range of services are offered to users of the exchange and that poor service levels are not being used to frustrate market development.

- Also in some Member States national boundaries set the geographic limit of exchange-based products. In some there are even legal obstacles to non-domiciled EXs offering services, for which they would like to compete with the national incumbent.

OTC trading still plays a crucial role including on the day-ahead markets. We emphasize the importance of OTC markets in supporting liquidity in European wholesale energy markets. In fact OTC trading is often the only competition for a particular EX in a given geographic/ product market. Our experience proves that the competitive environment between ‘transactions service providers’ has a positive effect in promoting best practices supported by market needs and ensures that exchange managers have an incentive to keep the fees charged for exchange trading at reasonable levels. Regulatory concerns about a lack of transparency in OTC markets should be managed in a proportionate manner, through the introduction of transparency and reporting rules, thereby encouraging efficient supervision and better price discovery of standard products, rather than by artificially skewing the regulatory framework in favour of exchange based transactions.

Therefore, EFET suggests a separate study by the European Commission and CEER of national frameworks for the operation of exchanges, with a view to optimising competition (irrespective of borders) and ensuring market participants enjoy the widest choice possible of trading platforms.

Additional remarks

The consultation document contains a few assumptions on which we would like to comment:

- Page 7: Exchanges *"are open to any participant"*: this statement oversimplifies an essential feature of a choice to do exchange trading: the payment of fees. Exchange trading is in fact only accessible to companies willing to pay not merely the basic fees, but also bear related internal costs (collateral for clearing, admission exams). Various categories of fees can be substantial (e.g. technological, annual, registration, per transaction). A few illustrative examples are given in the table below:

Exchange	Fees for a normal market participant in power market				
	Transaction	**Annual**	**Registration**	**Technical**	**Connection (annual)**
BELPEX	0.12 €/MWh	25.000 €	12.500 €	0€	0€
EEX	0.0075 €/MWh	25.000 €	0 €	0€	48.000€
EpexSpot	0.07 €/MWh	30.000 €	25.000 €	12.000€	48.000€
APX Power NL	0.07 €/MWh	28.500 €	5.000 €	5.000 €	0 €

  The above table can also be analyzed in relation with section 3.4 of the consultation document (definition of fees management and fees structure).

- Page 7: "*Unlike bilateral trading or brokered trading*", exchanges impose strict rules which contribute to the security of transactions. This statement again doesn't reflect properly the reality of bilateral and brokered trading which are both based on equally strict rules determined contractually, by agreement and internal (audited) risk management policies.

Questions for Public Consultation

1. In your view, is there a need to create EU level requirements for the organisation, functioning and regulatory oversight of energy exchanges not falling within the scope of MiFID? If yes, what should be the main goals and objectives to be fulfilled?

We are in favour of harmonised arrangements for EXs, however we believe that this process should be market driven. Therefore, we are not convinced that an additional European regulatory framework for the organisation, functioning and oversight of exchanges is necessary at this stage.

Concerning a possible revision of the oversight regime we believe that enhanced harmonisation is appropriate as far as it remains within the scope of REMIT, in particular in relation to the issues of disclosure of information, cooperation with authorities, improved coordination, centralization of reporting, sharing of information.

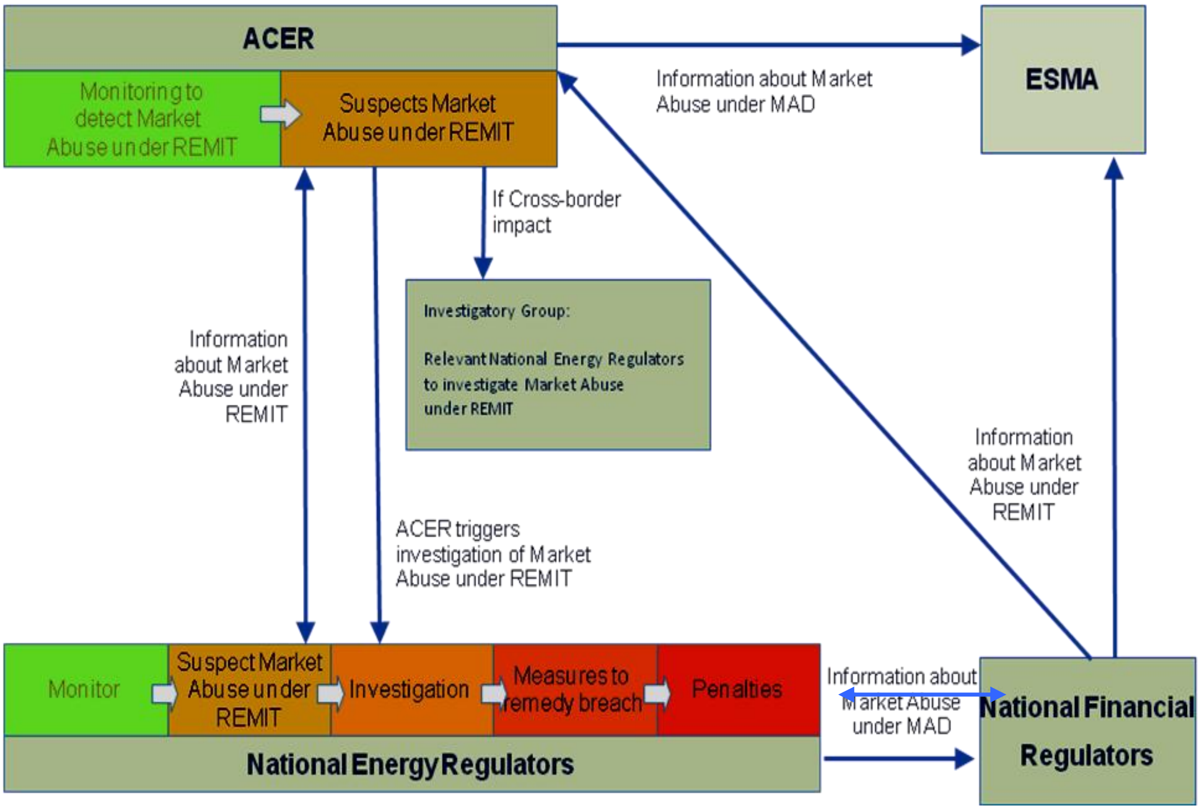
Indeed, the consultation document has not given evidence of any misconduct resulting from the current situation that would justify an additional intervention beyond REMIT. Under REMIT, trading at all organised markets will be monitored to ensure market integrity. Therefore, any intervention should be aimed at supporting a well functioning market integrity regime across EU Member States. Only after the effects of REMIT have become identifiable, further measures could be contemplated.

2. In your view, what are the remits of national energy regulators in supervising energy exchanges and how could a beneficial cooperation between them be organised, in particular for exchanges active under multiple national jurisdictions?

We tend to agree with the ERGEG statement that energy regulators should be competent with regard to the overall supervision and well functioning of the energy market, but again this should lead to a level playing field and not worsen the patchwork of rules and practices.

The design of exchange trading rules should be developed primarily by the exchanges and their members based on the market needs. We believe that the main responsibility of national energy regulators should be related to supervision of energy spot exchanges to the extent this supports a well functioning wholesale market.

The cornerstone of market supervision should be a central EU trade repository accessible to the national NRAs, entitled to conduct investigations and impose proportionate penalties within a harmonized regulatory framework envisaged under REMIT. Implementing rules should detail roles, tasks and responsibilities of each respective participant. Such framework can be illustrated as follows:



Based on this scheme, EXs active under multiple jurisdictions should then be monitored in parallel by ACER and the respective NRAs.These rules should ensure that market monitoring will be harmonised on a European level and provide for a similar standard of oversight in all Member States.

In particular for electricity, the fact that an exchange is active in more than one jurisdiction is not a real concern for market participants, especially in a context of European market integration, as long as exchanges can offer their services without relevant national obstacles and the essential features are harmonized with regard to cross-border activities, i.e. they use the same price coupling algorithm (day ahead) and they use the same shared order book (intraday). These functions, which moreover represent a residual activity of Power Exchanges are services performed on behalf of TSOs who are regulated entities which explains why the allocation functions should be accepted and approved by all involved NRAs and, in case there is no agreement between them, ACER should take a leading role to make a decision how to proceed and/or how to adapt these functions. In any case it is very important that stakeholders are consulted before such a decision is made.

In the case of gas, we have noticed in some emerging markets that there is a need to clarify between the roles of market operator, system balancer, facilitator of title transfer, and exchange. It is important for market parties to understand clearly the role of the regulated TSO, the potential for the TSO to offer unregulated services, and the provision of independent exchange-based services.

Finally, thought should also be given to the potential for undesired market behaviour across gas and power markets. Where a national platform is used to trade both commodities, this may suggest a joint surveillance team. Where commodities are traded on different platforms, for example a combination of national and international platforms, greater cooperation may be necessary.

3. Should the regulation of energy spot exchanges in future be covered by the energy market integrity regulation or by a separate future legal proposal by the European Commission?

REMIT will facilitate consistency and efficiency of energy market supervision. Thus, the regulation and the related implementing rules are the best instrument to ensure consistency on the application of a harmonised framework covering all categories of market actors (generators, producers, shippers, traders, TSOs, major customers and market operators) affected by potential market abuse/misbehaviour. From this perspective, we are of the opinion that it is more appropriate to avoid an additional piece of legislation.

4. How could in your view a harmonisation of legal and operational frameworks stimulate the cooperation of the European energy exchanges and what is the best way to involve the market/exchange participants?

Save for the abovementioned capacity allocation functions (e.g. the cooperation of EXs is very important when implementing projects of cross-border relevance, such as market coupling), we do not see a need for imposed top-down harmonization with respect to the competitive function of EXs.

We believe it would be sufficient to determine some minimum criteria, such as, for instance, the requirement that every exchange sets up a compliance team to monitor the rules and compliance with the legal requirements, which would have some clear and standard reporting obligations in the event a problem occurs.

Furthermore, it would be beneficial to develop common provisions on confidentiality and non-preferential disclosure of information to avoid potential conflict of interest scenario between exchange owners. The creation of special license conditions that do not unnecessarily expose exchanges to irrelevant network access conditions may also be helpful, especially in case of gas. Some member states have already created restricted licenses or other ways of treating an exchange as something different from a standard network user, such as continuous exclusive access to interconnection capacities in intraday.

We believe that initiatives endorsed by market participants allow sufficient incentive to promote a typical bottom-up harmonization process on functioning rules. As mentioned in the ERGEG draft advice document, market participants should be consulted on the development of exchange rules. In fact, this happens already as most of the power exchanges have a kind of “advisory board” where market participants are involved, e.g. the EPEX-spot exchange council or similar boards such as at APX. As market participants are already active in different markets, their advice will be based on the observed best practices and this will introduce a “natural” harmonization under pressure of the demands of the market participants. Such regulatory development process is optimal as market participants are able to make an appropriate evaluation of the costs and benefits.

5. Which criteria should a European framework for market makers include to avoid potential conflicts of interests?

Market making is an important feature in developing wholesale energy markets, in particular in the context of scarce liquidity. In our view this element should be considered when developing the regulatory framework to which energy traders should be subject. We believe it is the core responsibility of exchanges to ensure fair price signals and to stimulate plurality of market making. The nature of market making should remain voluntary and limited to certain markets/segments, depending on various factors, including level of liquidity, market design and possible implications in terms of applicable financial regulation. For instance, we do not believe that specifying a role of a market maker on a spot exchange for a commodity is necessary.

In electricity, for example, generators should offer capacity to the power exchange and should test via their buying offers whether other market players could generate cheaper than their most expensive plant (i.e. the "make or buy decision process"). Moreover, the market coupling process will provide sufficient liquidity as not only domestic offers are matched, but also foreign offers depending on the available cross-border capacity. The same analysis is valid for electricity cross-border intraday models, as far as the shared order book function as provided brings intraday liquidity together.

For future markets, it is more important to have only "voluntary" market maker rules which result from commercial discussions between exchanges and market participants. In very liquid markets, there is actually no strong case for having market makers in place. In less liquid markets, excessive rules and requirements will create an aversion to this role. Where specific local players have been identified as potential market makers – e.g. as an obligation to mitigate dominance – then this would be an issue between that company and the relevant authority; it does not seem to be appropriate to address this issue in oversight rules concerning exchanges.

6. How could national energy regulators better work towards publishing of price sensitive information as e.g. foreseen in the ERGEG advice on Guidelines on Fundamental Electricity Data Transparency to increase the level of transparency?

We believe that fundamental data and transactional data should be clearly distinguished. All this information can be considered price sensitive, but the nature and origin differ in the two cases. In many cases TSOs already have access to fundamental data from producers and shippers and in some countries they are also in charge of publishing such information (e.g. RTE, REE, Elia and Terna). On the contrary, EXs (and brokers) have access primarily to transactional data. Existing initiatives should be taken into account when Guidelines are finalised and EX platforms may play an important role to the extent they contribute to the target of a common point of access to these data. Therefore, we think that the publication of data on exchange websites can be pragmatic but should not be imposed by law. We rather suggest focusing on the standardization of data, of responsibilities to disclose data to be published, and of timing of release of data.

7. Which measures could in your view lead to a sufficient cooperation of market surveillance departments of the energy exchanges and the national energy regulators?

We would revert to the diagram inserted under question 2. In our view, REMIT offers the necessary tools to facilitate sufficient cooperation of market surveillance departments.

In markets where the relationship between EXs and Regulators is not yet in place, it should be introduced. Therefore ERGEG/ACER should advise the EU Commission on the importance of this aspect.

Sufficient cooperation will be achieved through regular access to market data by NRAs and their regular monitoring of market outcomes, by reference to transactions concluded in standard products.

More in practice, NRAs should specify what information they require from exchanges to enforce e.g. REMIT and report to NRAs when anomalies occur. If necessary, there could be a cooperation between ACER and energy and financial NRAs, on one side, and Exchanges vis-à-vis NRAs/ACER, on the other.

8. What are in your view minimum standards for a harmonised approach to protect energy exchanges from misbehaviours like market abuse?

A proper regulatory supervision framework should enable EXs to support the task of energy regulators in detecting market misbehaviors. We believe that the framework introduced with REMIT and MAD (where applicable) is an appropriate response to prevent situations of market abuse in energy markets. In this context, as stated in the introduction we believe that the role of EXs should mainly consist in identifying and reporting to the relevant authorities (including the involved NRAs, ACER) the potential problems they might detect. The role of EXs should be limited to this task and investigations, where necessary, should then be organized by the relevant authorities. In order to ensure a harmonized and an objective evaluation of the potentially observed (mis)behaviour, we believe it is also important for a central authority (like ACER) to be involved in the investigation process, if it transcends national boundaries. This will lead to a more harmonized process over time.

Nevertheless, we recognize that some exchanges may already be regulated under financial legislation. Where provisions are already clear on the obligations to report the alleged activity, we advocate against endorsing duplicate legislation, whilst we believe that cooperation between different regulators is the preferred approach.

We hope that our comments will be taken into consideration in this process. In case of any queries, please do not hesitate to contact:

Dr. Karl-Peter Horstmann, Chairman of EFET Task Force Market Supervision (*karl-peter.horstmann@rwe.com*);

Mr. Cemil Altin, Vice-Chairman of EFET Task Force Market Supervision (*cemil.altin@edftrading.com*);

Riccardo Rossi, member of EFET Task Force Market Supervision (*riccardo.rossi@eon.com*);

Peter Styles, Member of the EFET Board, Chairman of the EFET Electricity Committee (*P.Styles@efet.org*)