



ACTIVITY REPORT
2016

EFET

European Federation
of Energy Traders
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EFET MISSION STATEMENT

The European Federation of Energy Traders (EFET) promotes competition, transparency and open access in the European energy sector.

We build trust in power and gas markets across Europe, so that they may underpin a sustainable and secure energy supply and a competitive economy.

We do this by:

- Working to improve the functionality and design of European gas, electricity and associated markets for the benefit of the overall economy, society and especially end consumers.
- Developing and maintaining standard wholesale supply contracts and standardising related transaction and business processes.
- Facilitating debate amongst TSOs, regulators, policy makers, traders and others in the value chain about the future of the European energy market.

We represent more than 100 member companies, active in over 27 European countries.

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EFET European Federation Energy Traders

THE MARKET

Jan van Aken
EFET Secretary General

FOREWORD BY EFET SECRETARY GENERAL

The need for adaptability

Looking back at 2016, we have seen new challenges facing the European energy sector. Adaptability to the changing circumstances is the key to survive and prosper. Some new challenges involved the market catching up with policy and regulatory changes. Other challenges involved legislation and regulation lagging behind the emerging needs of the market. Timing is essential: the market and legislation should preferably march more in lockstep.

In the wholesale gas markets for example it feels often as though we are addressing the problems of five years ago, rather than the problems of today. This is the case with implementation of network codes on gas transportation capacity and congestion management, as well as the proposals for new rules around incremental capacity. These came from a time when market access was being obstructed by long term capacity contracts, when TSOs' pipelines

were fully underwritten by existing contracts so there was little incentive for them to resell non-utilised capacity to others. How times changed. Now, capacity is plentiful. A reduction in demand – in part (1) through reduced economic activity, in part (2) through low use of gas as a generation fuel, and (3) in part through recent mild winters – has led to a corresponding reduction in the need to hold capacity. Bypass of traditional routes has left some pipelines with very low flows, while the prospect of landing LNG cargoes closer to market may have similar effect. As infrastructure utilisation falls and the risk of stranding increases, shippers fear holding long term commitments. These leave them with the risk of paying for a disproportionate share of the affected assets. The market has changed fundamentally, the original problem is no longer a concern, and we are dealing with new challenges, which may be complicated by the new “old” solution.

Foreword by EFET Secretary General

Therefore the legislation needs to deliver solutions in a timelier manner, if the market is to have the chance to implement them.

The electricity system in Europe is also at a turning point. Collectively, we have reached an unprecedented level of liberalisation and integration of the whole electricity sector in Europe. Unfortunately existing legislation sometimes prevents the market from delivering the right signals and regulatory changes do not always reflect market needs: patterns of generation, supply and demand are changing. Generation sources are increasingly renewable and decentralised. Points of demand are in some cases becoming points of auto-generation and storage, even on a very small scale within residential premises. The legal framework needs to ensure that new actors can enter the market without undue restriction, but also that all participants in the wholesale electricity market are treated

on an equal footing. In addition, more intermittent power generation in the European energy mix means we need more precise price signals to ensure the reactivity of market participants' dispatch decisions to rapidly changing demand and supply conditions. We need these price signals to provide the right basis for investment in power generation, demand response and storage without resorting to subsidy schemes. Energy prices should be allowed to reflect the true value of scarcity during times of system stress and high demand for power. Volatility of energy prices is a sign that the market reacts appropriately and fast to demand and supply signals. For a seamless integration of existing and new technologies, decision makers need to do away with interventions aimed at suppressing scarcity or surplus pricing, which jeopardize the effective functioning of the market. Our industry had to adapt equally to the broad spectrum of reforms triggered by the financial

crisis. The management of counterparty credit risk has been targeted by mandatory exchange trading for financial firms (under MiFID II) and obligatory clearing of OTC derivatives (under the European Market Infrastructure Regulation, EMIR). In parallel to the crisis, concerns about the role of speculation in rising commodity prices led to an increased focus on market conduct and transparency and to the desire to extend the reach of financial regulation to the physical markets and participants. Some of these reforms were due: The Regulation on wholesale Energy Market Integrity and Transparency (REMIT) and the reformed Market Abuse Regulation and Directive (MAR/MAD) helped to ensure that markets are not only fair and transparent, but are also seen as such.

A good example of an adaptable market mechanism is the EU Emissions Trading Scheme (ETS). A strong EU ETS can lead to electricity

Foreword by EFET Secretary General

prices which better reflect the decarbonisation components and costs. Consequently, this would help phase-out RES subsidies, making the decarbonisation process of Europe more cost-efficient. In the longer term (post-2020) the success of the EU ETS in delivering European decarbonisation targets will depend upon more comprehensive structural reforms.

On the political front in 2016 we were confronted with another example of how essential for the preserving of the single energy market is the ability to adapt to changes and face new challenges: Brexit. The outcome of the vote in favour of the UK leaving the European Union has surprised many. Everyone assumes that a divorce is costing effort and money. After more than 40 years of stately marriage, there is no winner or loser, as each party to a divorce may be able to book "wins" and "losses" at the same time. Any divorce may open up opportunities

for the parties involved. For the UK, its possible re-invention in "splendid isolation" raises the prospect of a European off-shore financial centre, aloof from future EU economic, monetary and fiscal policies. For the EU, the departure may inspire a reform of the current institutional set-up. But for EFET a middle path will be preferable, one which permits the accumulated benefit of power and gas wholesale markets open to competition across borders, including the English Channel, to be retained.

The way forward for EFET is to help our member companies to adapt to new rules, even if they are unwelcome and appear to interfere with market functions or impede freedom to trade. EFET will advocate amendments to old rules or practices, even the introduction of new measures, if needed, to facilitate market development and underpin competition and liquidity. Meanwhile, through our work on contractual

and IT standardisation, trading compliance and credit at EFET, we continue helping our member companies to adapt to changing business management challenges. Overall, we will keep loyal to our mission, confident that our members and their customers can rely (even more in coming years) on the market.



Jan van Aken



European Electricity Market

Introduction

The EFET Electricity Committee comprises representatives from over forty member companies, about twenty of whom are particularly active. It meets five times a year. We take the opportunity of quarterly meetings of the EU Market European Stakeholder Committee (MESCC), convened by ACER, to work in detail on the implementation of electricity market network codes and guidelines together with DG ENERGY, ACER, ENTSO-E, Europex and Eurelectric. Delegates from the Electricity Committee also actively participate in the bi-annual meetings of the Cross-Border Electricity Forum (so-called "Florence Forum"), where the European Commission invites the above-mentioned parties to discuss broader market design questions, together with EU Member State government and national regulator representatives and some other special interest groups. Our most recent interventions at the Florence Forum in September 2016 focused on demand-side response and free formation of prices.

EFET secretariat and member company representatives are also active members of a variety of other technical expert groups, such as the CWE Flow-Based Consultative Group, the Cross-Border Intraday User Group, the Electricity Balancing Group and the Bidding Zones Stakeholder Advisory Group. Our presence in these circles, alongside our numerous bilateral meetings with representatives of the European Commission, ACER and ENTSO-E, facilitates our advocacy work and allows us to influence decision-making at senior level. The Electricity Committee keeps close ties with, and occasionally partners with, other trade associations to campaign on power market design questions of common concern. Occasional partners include Eurelectric, Europex, the Smart Energy Demand Coalition (SEDC), WindEurope and SolarPower Europe.

Central West Europe (CWE) flow-based market coupling in electricity: closing the transparency gap

In May 2016, CWE regulators finally supported our request for the publication by TSOs of detailed information on the so-called “critical branches” and their activation, which govern the constraints applied to the flow-based algorithm, as well as remaining available margins. Regulators also agreed with the long-standing EFET message that current external constraints applied by TSOs in the flow-based algorithm lack justification. **Thanks in part to continued pressure from EFET, full transparency on the “critical branches” and their activation, as well as remaining available margins, are available in France, Belgium and the Netherlands since September 2016.**

In the framework of the CWE Flow-Based Consultative Group (CCG), **EFET teamed up with Eurelectric and the Market Participants Platform (MPP) for this region to improve market participants’ understanding of the practical functioning of flow-based market coupling.**

Together, we submitted a series of requests to incentivise regulators to go beyond the general statements of support we had received from them so far and take concrete actions to force TSOs to ensure appropriate transparency.

Though this is a significant step forward to allow market participants to reduce uncertainty related to the functioning of the flow-based algorithm, the battle is not over yet: **German TSOs are still challenging the request of the CWE regulators and are in negotiation with the German regulator BNetzA.** Our Electricity Committee is working to ensure full transparency across the region, including on the “critical branches” within Germany and between Germany and its neighbours.

CWE FLOW-BASED MARKET COUPLING

In May 2015, the TSOs of France, Germany, Belgium and the Netherlands started calculating and allocating cross-border transmission capacity in the day-ahead timeframe with the flow-based methodology. This new capacity calculation method optimises electrical flows on a regional basis and allows increasing the capacity allocated at the bidding zones borders within the area. Flow-based market coupling is based on a complex algorithm taking into account various internal and cross-border grid elements and constraints resulting in daily changing and difficult to predict capacity values at each bidding zone border. EFET had warned TSOs of this challenge long before the go-live of flow-based market coupling and worked with regulators to ensure that traders are given all the necessary information to forecast allocated capacities. However, despite a clear request from regulators in March 2015, transparency on the flow-based market coupling algorithm inputs was still lacking until the autumn of 2016.

References

-  [Memo on transparency on flow-based market coupling parameters](#)
-  [Flow-based market coupling and the use of remedial actions](#)

“Transparency on TSOs grid usage is vital in the new and complex flow-based capacity calculation environment.”

Hélène Robaye
Power Asset Regulation and Analysis, Engie



Full financial firmness of electricity transmission rights

EFET has successfully convinced European TSOs and regulators to work on updating the EU Harmonised Allocation Rules (HAR) for the auctioning of forward transmission rights. **This is a significant success for EFET as it guarantees full financial firmness of transmission rights – at least in the CWE region for the moment – as of 1 January 2017**, a year in advance of what European legislation would have otherwise required.

We have repeatedly insisted in more than a dozen consultation responses and letters to ACER and ENTSO-E since 2013, at the HAR stakeholder advisory group meetings organised by ENTSO-E, and at the European Market Stakeholder Committee (MESc) meetings, **that TSOs should issue financially firm transmission rights at all bidding zones borders in all directions.**

Representatives of the EFET Electricity Committee to the MESc and FCA meetings of January and February 2016 managed to garner support from ENTSO-E and ACER to pressure reluctant TSOs and regulators to adopt an amended version of the rules compliant with the version of the Forward Capacity Allocation (FCA) Guideline approved by Member States on 30 October 2015.

The new rules limit the ability of TSOs to curtail transmission rights allocated to market participants, and provide **compensation at market spread in case of curtailment** – except for Force Majeure events, which are compensated at the original price paid. Some regional exceptions will remain at least until the end of 2017 at the Italian, Swiss and Eastern European borders, as well as in the British Isles. We will work together with the TSOs and regulators to ensure that the full firmness regime of the FCA Guideline is applied everywhere.

The Electricity Committee is proud of the outcome of this strong advocacy effort and will monitor the swift implementation of the rules in preparation for the first 2017 yearly capacity auctions in the fall.

“Greater firmness means transmission rights are more attractive for traders, and more profitable for TSOs.”

Alice Barrs
Market Design and Regulatory Affairs,
RWE



FORWARD TRANSMISSION RIGHTS

Since its inception, EFET has been making the case for forward transmission rights: even more so than today, transmission rights have accompanied the liberalisation of the electricity wholesale markets from the early 1990s as a natural hedge against long-term price risks across borders. Still today, forward markets represent the vast majority of transactions on the electricity wholesale markets. Here are some of the benefits that can be expected with the maximisation of capacity allocation via financial firm transmission rights:

FOR CUSTOMERS firm transmission rights facilitate access to cost effective power supplies; enhance service reliability; facilitate optimal use of the transmission grid; and ensure grid enhancements are performed at the lowest possible cost.

FOR TSOs firm transmission rights provide increased revenues as grid users will pay more for firm capacity; encourage system optimisation; provide clear rules for provision of the service; ensure management of transmission risks by the most appropriate party; and facilitate the secondary market, giving TSOs more opportunities to manage capacity rights.

FOR REGULATORS firm transmission rights offer cost benefits for customers; provide transmission system optimisation at the right cost from a social welfare perspective; and place the risk of ensuring firmness on the party that can take the necessary measures.

FOR TRADERS firm transmission rights provide the ability to supply at lower prices to customers and accurately hedge forward power positions; facilitate the development of secondary capacity market; and provide clear rules for provision of service.

The Commission Clean Energy Package: Putting the consumer at the centre of the energy transition without relegating markets to a dark corner

On 21 November 2016, the Chairman of the Electricity Committee informally communicated the concerns of EFET members with regard to a number of provisions in the upcoming 'Clean Energy Package' after we got access to leaked versions of the draft proposal. We drew the attention of Commission services to a few particularly worrisome and urgent elements.

In the draft recast Electricity Directive, retail questions are put at the forefront and wholesale market questions are relegated towards the end of the text. The latter remain broadly unchanged – for better for the most part, and worse when it comes to **the oblivion of the contribution of the forward timeframe to the internal electricity market**. The Commission proposes to introduce a number of new topics into EU legislation, such as provisions on electricity storage, demand-side response and indepen-

dent aggregation. **One of the most worrisome parts of the draft recast Directive concerns the promotion of aggregation of demand-side response (DSR) and/or supply: we raised concerns about Art. 16.2 (d), which excludes the compensation of generators or suppliers by the aggregators in case of DSR activation.** This provision rules out any physical or financial balancing responsibility of independent aggregators. And this at the time when universal balancing responsibility of all market participants finally made its way into the draft recast Regulation.

The review of the Renewable Energy Directive is more encouraging, **with improvements to be expected in terms of integration of renewables into the wholesale market:** the draft recast Renewable Energy Directive foresees the partial opening of RES financial support schemes to cross-border participation, universal balancing

responsibility, and the phase-out of priority dispatch for new installations. However, **the Commission could have gone further and pushed Member States to give up priority dispatch for all installations, and forbid any type of support in case of negative prices to avoid further market distortions.**

“The greater focus on consumers in the clean energy package will only bear fruit if market rules are designed properly.”

Jérôme Le Page
EFET Manager for European Electricity Markets



CLEAN ENERGY PACKAGE

On 30 November 2016, the European Commission issued the long-awaited 'Clean Energy Package'. This package of legislative reform proposals aims to reshape the legislative and regulatory framework for electricity markets and RES promotion.

The Package comprises four Communications and eight legislative proposals:

- draft recast Electricity Directive
- draft recast Cross-Border Electricity Regulation
- draft recast Renewable Energy Directive
- draft recast Energy Efficiency Directive
- draft recast Directive on the Energy Performance of Buildings
- draft recast Regulation on ACER
- new draft Regulation on Risk Preparedness in the Electr. Sector
- new draft Regulation on the Governance of the Energy Union

Demand-side response and electricity storage: Openness to innovative solutions, as long as they compete on a level-playing field

On 28 July 2016, EFET, Eurelectric and Europex issued a joint statement in reaction to the declarations made by the European Commission on demand-side response (DSR) at the Florence Forum of 13 and 14 June 2016. The joint statement underlines that **the electricity market offers the only viable framework to meet the challenges posed by the rapid growth of intermittent renewable generation sources, including an increasing need for flexibility, reliability, responsiveness of demand and access to storage.** To ensure a level-playing field between all market participants proposing DSR services, **EFET argues that balance responsible parties (BRPs) must retain their pivotal role in the European electricity market design** and continue to enjoy corresponding rights as well as responsibilities.

With regard to access to electricity storage, our position paper of October 2016 insists that DSOs, like TSOs, are and should remain - by providing access to their networks - neutral market facilitators and should not participate in commercial activities like power generation, demand-side response and storage.

The Electricity Committee and the relevant EFET Task Forces will continue to monitor developments on the subject at EU level and in individual Member States. EFET will pursue advocating **a well-functioning energy market, with strong price signals, as the best solution to unlock the flexibility potential of demand and storage.**

References

-  [EFET response to the EC consultative communication on Electricity Market Design](#)
-  [EFET paper on the importance of free formation of prices](#)
-  [Joint statement on demand-side response](#)
-  [EFET reaction to the CREG interim report on measures to improve access to demand-side flexibility in Belgium](#)
-  [EFET position paper on the roles and responsibilities of DSOs, particularly regarding access to electricity storage](#)

“Increasing flexibility or promoting demand-side response should not be goals as such. The energy market itself will deliver the right amount of flexible capacity at lowest costs, if price formation is unrestricted and if a level playing field between all market participants is ensured.”

Paul Giesbertz
Regulatory Affairs, Statkraft



USE OF FLEXIBLE CAPACITY IN THE WHOLESALE POWER MARKET

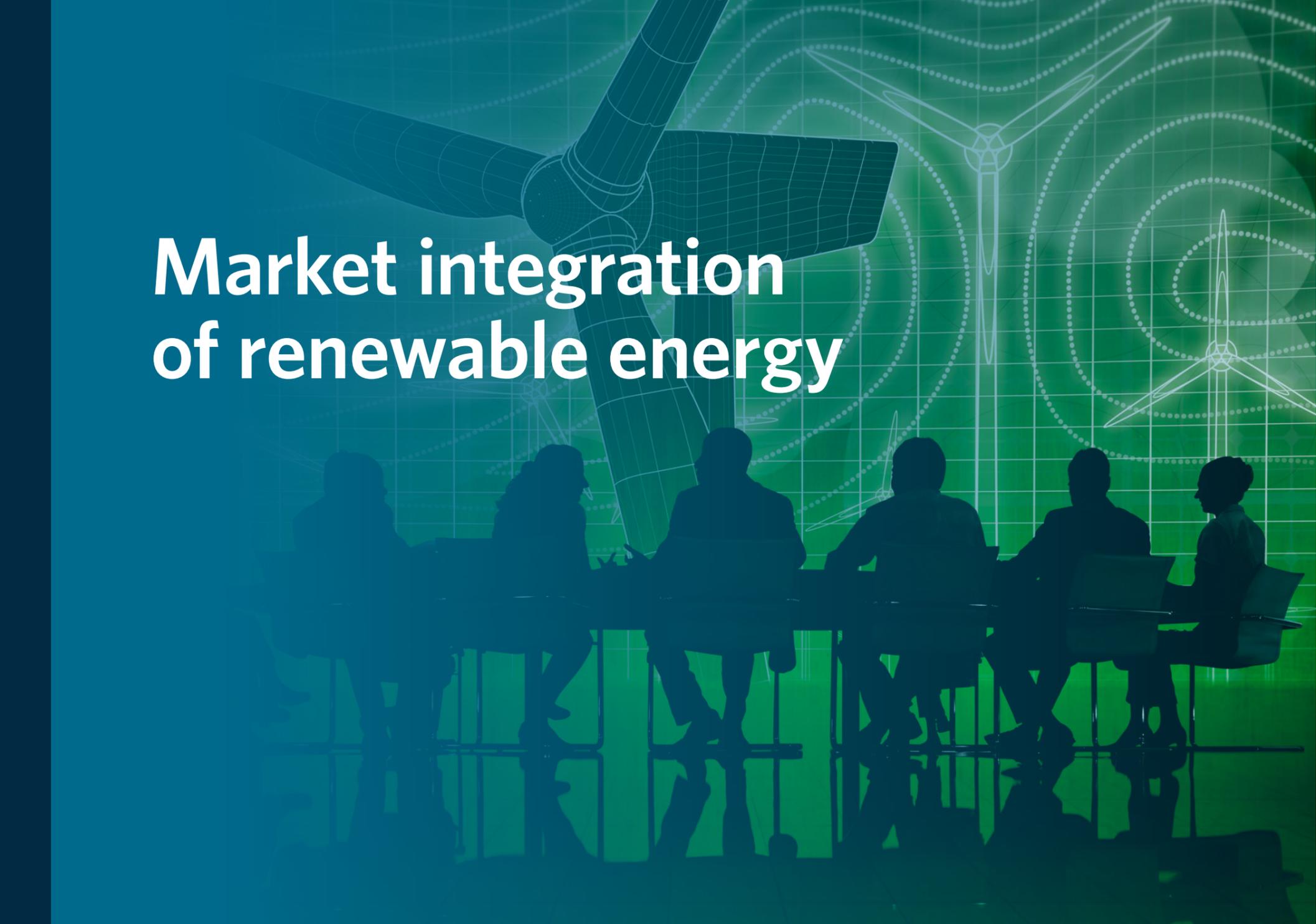
In 2015, conscious of the importance of the contribution of generation, demand and storage to tackle the growing need for flexibility in the European power markets, the EFET secretariat invited EFET Electricity Committee members to reflect on the definition of flexibility and its valuation in the market, including through possible market design improvements. We introduced our understanding about the role of flexibility for the market for the first time at the Florence Forum meeting in June 2015. EFET members firmly believe that a level-playing field should be guaranteed to all flexibility providers by avoiding subsidy or special regulated privileges. Any revisions to the market design must not imperil competition, market liquidity and the efficient functioning of the market. Unbundling of transmission businesses from businesses involving generation, supply, storage or the provision of ancillary services remains crucial.

Outlook for 2017

While the political orientations of the Union – energy transition towards a low-carbon economy, key role of the consumers – will not be up for discussion, we will insist on making sure that the revised framework for electricity trading in Europe guarantees **a level-playing field between all market participants**. We will remain vigilant about all potentially distortive regulatory interventions such as the dilution of unbundling rules, flaws in the design of capacity mechanisms, or the establishment of privileges for the participation of generation and demand aggregators in the market.

Our objective for 2017 is that policy makers remember **the vital importance of the electricity market**: it is the only viable framework to integrate renewable energy and meet the growing need for flexibility, reliability, responsiveness of demand and access to storage. We will carry this message to the European Commission and to relevant contacts in the European Parliament and among Member States in the run-up to the adoption of the Clean Energy Package.

We will also continue our constant interaction with ACER, ENTSO-E and the community of national regulators and TSOs to ensure ambition in **the implementation of Network Codes and Guidelines and transparency in the operation of transmission networks**. Our goal will remain to further harmonise, integrate and open up to competition all segments of the market, from the forward timeframe to the balancing market and ancillary services.



Market integration of renewable energy

Introduction

The EFET Task Force Renewable Energy has continued to advocate the full integration of renewable sources (RES) into the wholesale power market. We have urged a thorough review of legislative privileges for renewable generators and of RES financial support schemes. Papers we issued early in 2016 advocated a focus on **re-creation of a level-playing field in the wholesale power market**, by exposing renewable generators to normal connection, dispatch, congestion management and

balance responsibility disciplines. We argued furthermore that renewable electricity financial support schemes, if truly needed in the future, should be reformed to respect the spirit of EU State aid rules. This means they must be market-based, they must discourage bidding at negative prices at times of oversupply and they must be amenable to cross-border trade of renewable generation attributes within the EU internal market.

Contributing to the market integration of renewable energy

EFET advocacy has helped make the integration of renewable generation sources in the wholesale electricity market one of the EU Commission's main priorities. This priority is clear in the Commission's proposals for a revised Renewable Energy Directive (RED II) and for a new Electricity Market Regulation, both for implementation from 2020 onward, published in December 2016.

In response to the EU Commission public consultation in preparation for RED II in autumn 2015, EFET advocated the re-evaluation and reform of privileges that have been granted in the past. We also argued that financial support for new or less mature technologies can still be provided, but should be rationalized overall: going forward, investment should be driven by economic rationale, considering demand, location and network topology on a pan-continental basis, rather than by the national incidence and level of subsidies.

Later in April and September 2016 in a joint paper with Europex and at meetings with Directorate C of DG Energy of the European Commission, we insisted on a number of ways to strengthen the market integration dimension of the new renewable energy legislation. EFET and Europex were also requested in the autumn by DG Energy to advise on a market-based mechanism, to allow statistical transfers between EU and EEA Member States in relation to their binding 2020 targets for the share of renewable energy in their final energy consumption. In response to this request we delivered a joint paper to DG Energy proposing an auction-based inter-state mechanism, which would allow underperforming countries to reach their 2020 RES target by virtually buying the 'green' surplus of overperforming countries.

In October 2016, an EFET delegation met officials in Unit C1 of DG Competition to discuss the integration of RES-E in the wholesale electricity market. The discussion focused on a discouragement of bidding at negative wholesale power market prices, as required by the applicable Guidelines on State aid. But we also touched on possible cooperation between Member States in the organisation of financial support for RES generators and on how the tradability of RES-E attributes across borders could function.

RENEWABLE ENERGY SOURCES

The development of wind and solar generation in Europe since the early 2000s has largely been supported financially outside the normal operation of the electricity market; in addition privileges currently enjoyed by wind and solar power generators under national and/or EU legislation variously include priority dispatch, priority grid access (notably advantageous connection charges) and exemption from balancing responsibility.

"EU-wide RES market integration is a key driver for success in meeting EU targets."

Stefan Ulreich (E.ON)
Chair of the EFET TF Renewable Energy



Disincentives to RES-E generators in times of negative prices

Throughout 2016 we have provided expertise and knowledge to the EU Commission on the issue of incentives granted to RES-E generators in times of negative prices, in the context of the wider topics of RES-E integration in the wholesale power market and of the role of scarcity pricing.

In April 2016, DG Competition asked for an advice on whether national initiatives already in place, such as in Germany and the UK (so-called 'six-hour rule'), shall be considered as best practice. Representatives from the Commission were also eager to understand how practically to design a scheme, whereby RES-E generators are not incentivized to produce, when prices are expected to turn negative. **We elaborated ideas to limit 'perverse' bidding behavior**, namely applying limits to the output eligible for subsi-

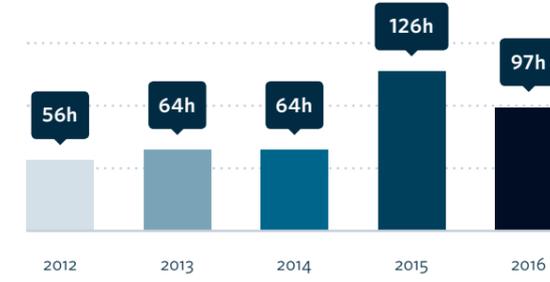
dies or oblige RES-E producers to sell ('write') put options at their marginal cost (often zero), forcing them to buy back their energy when prices become negative.

A solution, which is in line with the Guidelines on State aid in this respect, is still under consideration by the Commission, but EFET will continue to offer expertise and advice to the EU institutions.

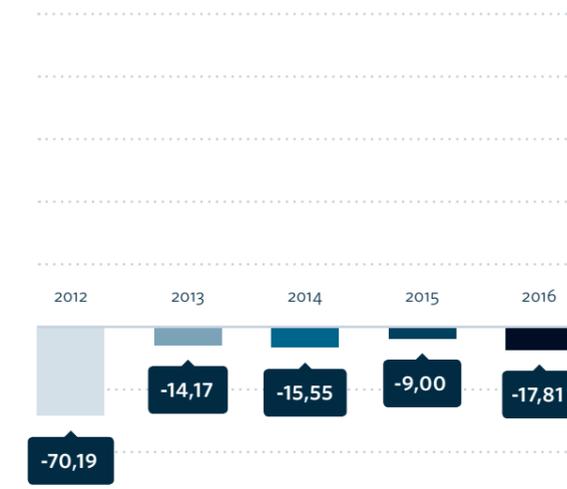
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-  [EFET response, 4 February 2016 - EU Commission consultation for preparation of a new renewable energy directive for the period after 2020](#)
-  [EFET-Europex letter to the EU Commission on RES-E market integration, 23 February](#)
-  [EFET-Europex joint letter on a RES statistical transfer mechanism, 2 May 2016](#)

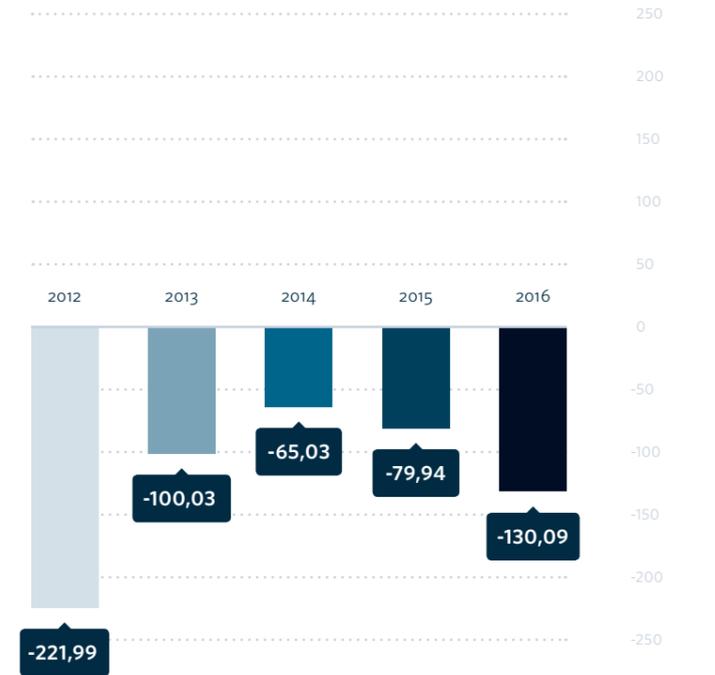
Number of negative hours



Average negative price in EUR/MWh



Lowest negative price in EUR/MWh



Number of hours with negative power prices, the average price level of negative hours and the lowest negative power price for the years 2012 to 2016 (Source: Agora Energiewende "Die Energiewende im Stromsektor: Stand der Dinge 2016").

Outlook for 2017

In coordination with the Electricity Committee the TF RES **is preparing a reaction to the Commission's proposal for a new RES Directive** as part of the recently published Clean Energy Package. (See the article on the [Commission Clean Energy Package](#) under the report of the work of the Electricity Committee). Our advocacy efforts in 2017 will target the EU Parliament and then the EU Council to push reforms of the legislative framework for financial support of RES and for operation of the electricity market towards fuller integration of RES-E output at the wholesale level.

EU Emissions Trading System



Introduction

The EFET Task Force (TF) Emissions Trading has continued promoting deep reform of the EU carbon emission allowances (EUAs) market post-2020 (Phase IV). TF members remain certain **that a reformed EU Emission Trading System (EU ETS) is the right market-driven means to deliver the objectives of EU climate change policy, through a reduction of carbon emissions in a cost-effective manner across the whole economy.** However, today's reality is that the EU ETS is drastically oversupplied and that the oversupply has prompted a prolonged period of low EUA prices. Furthermore, continuing subsidization of most renewable sources (RES) of electricity generation masks demand for EUAs which might otherwise transpire.

We continued our collaboration with IETA, which started in early 2015 and resulted in the co-organisation of two thematic workshops on EU ETS reform. We urged policymakers to restore the EU ETS as the central pillar of EU climate change policy and of stimulation of RES going forward: in particular, we focused our advocacy on how to tackle so-called 'overlapping policies' to address carbon reduction, including national RES and CHP support schemes. To EFET members the detriment to the carbon abatement price signal occasioned by such policies seems far more important than the risk of carbon leakage beyond EU frontiers, which has dominated recent EU policy discussions.

Tackling overlapping policies

In 2016 we succeeded in raising ‘overlapping policies’ as a central issue to be tackled by the EU Parliament as part of the EU ETS reform:

we contributed actively to the debate on ‘overlapping climate policies’ by releasing a discussion paper on 18 January 2016, in which we suggested a number of ways forward. In particular we urged policymakers:

- To perform a serious qualitative and quantitative re-evaluation of the extent and anticipated impact of overlapping climate policies in the coming months.
- To tackle the lack of transparency through systematic and periodic monitoring of impacts and transparent publication of information.
- To reinforce EU ETS governance and to take a more active role in addressing the above mentioned distortions.

- To strengthen the Market Stability Reserve (MSR) at the earliest opportunity increasing the EUAs withdrawal rate so that the existing surplus of allowances can be reabsorbed more rapidly.

As part of our advocacy efforts, we discussed these policy options bilaterally with Ross McKenzie, Head Policy Assistant to MEP Ian Duncan (ETS Rapporteur in the EU Parliament) and with Dr. Stefanie Neveling of the German Federal Ministry for Economic Affairs and Energy during the month of March. We also had the opportunity to present our ideas to relevant MEPs, including Rapporteur Duncan, during a dinner organised in Strasbourg on 8 June in collaboration with IETA, Eurelectric, Eurogas and Wind-Europe. Both the ITRE Committee draft opinion on the EU ETS reform of 18 May 2016 and the subsequent ENVI Committee draft report on the EU ETS Directive review were landmarks. In these reports the parliamentarians recognised

the importance of measures aimed at removing the conflicting signals arising from a weak carbon price on the one hand, and from uncoordinated national measures to address climate change, particularly to promote RES output and efficiency, on the other hand.

A distinguished recognition of our efforts came by the ENVI Committee Opinion on the EU ETS Phase IV, adopted on 15 December 2016: the Opinion envisages that each year the Commission shall submit a report on the functioning of the carbon market, with a dedicated section exploring the interaction of the EU ETS with other Union climate and energy related policies. This was backed-up by the European Parliament’s plenary vote from 15 February in favour of important measures aimed at strengthening the EU ETS. These include doubling the intake rate of the Market Stability Reserve (MSR) to 24% (2019-2022), and the cancellation of 800 million allowances from the MSR in 2021 “

“It is a pity that the initial promise shown by the operation of the EU emissions trading system around ten or eleven years ago has faded. A persistent oversupply of allowances, combined with a drop in demand occasioned by the economic downturn and by generous direct financial support for RES-E, has progressively dampened the carbon reduction signal. But these circumstances are not irreversible.”

Peter Styles

Chair of the EFET Electricity Committee



OVERLAPPING POLICIES TO TACKLE CLIMATE CHANGE

Overlapping policies have the effect of reducing carbon emissions in ETS sectors, but not as a direct result of the price signal arising from the carbon market. These policies directly undermine the effectiveness of the EU ETS, by reducing demand for energy and/ or EUAs, thereby acting as ‘substitute’ abatement mechanisms. The massive oversupply of EUAs, which prevents the establishment of any meaningful CO2 price signal, has contributed with an extra incentive to the introduction of inefficient and costly carbon abatement actions, thus creating a “non-virtuous” circle.

-  [Tackling overlapping policies with the EU ETS- EFET discussion paper, 18 January 2016](#)
-  [EFET comments, 18 May 2016 - Committee on Industry, Research and Energy \(ITRE\) draft opinion](#)
-  [EFET comments, 21 June 2016 - Committee on the Environment, Public Health and Food Safety \(ENVI\) draft report](#)

Outlook for 2017

EFET will continue to emphasising that the time for a change in the EU carbon market is now. Our Task Force will be looking for opportunities to point out that **the success of the EU ETS in delivering European decarbonisation targets will depend on a solid package of additional structural measures for the post-2020 period.** For this purpose we will be engaging with the EU Commission, Parliament and Council as part of the trilogue negotiations. We will plead for restoring of the central role of the EU ETS in reducing carbon emissions cost-efficiently.

European Gas Market



Introduction

The EFET Gas Committee comprises representatives from nearly forty member companies, around half of whom are active attendees and frequent contributors. It meets around six times per year. The Committee promotes good wholesale market design and hub liquidity through engaging with key opinion-formers, organising and participating in workshops, writing position papers, responding to consultations, and speaking at conferences. Representatives attend the now annual European Gas Regulatory (“Madrid”) Forum on gas market activities, Gas Regional Initiatives, and industry workshops. This is done in conjunction with the European Commission’s DG Energy, CEER, ACER, ENTSO-G and GIE, National Regulatory Authorities and Member State representatives. The Committee also collaborates with other network user groups.

The Committee has formed four key Work Groups to focus on specific issues relating to Gas Transportation Capacity, Tariffs, Gas Hubs and Balancing, and Security of Supply (including Storage and LNG). These groups have been instrumental in designing and challenging new network codes in areas related to capacity allocation, congestion management, market-based balancing, tariff methodologies, and interoperability, each with provisions for information transparency. The groups have developed best practice models – most notably for good practice in gas hub design, and including a widely-referenced annual benchmarking study to measure progress in illiquid hubs. There is also an increasing focus on local implementation of European regulations and network codes through national and regional Task Forces in Germany, France, Italy, Iberia, BeNeLux, and Central and South Eastern Europe.

Access to transmission networks and gas capacity messages

Through the ENTSOG stakeholder joint workshops, prime-movers group sessions and ACER Impact Assessments, EFET and members have engaged actively to increase the effectiveness of the Network Code on Capacity Allocation Mechanisms (NC CAM). Our advocacy in this regard aimed at improving convergence in capacity products and terms on European and national implementation scale, and promoting the continued use of single-sided capacity sales where this is not possible, to reduce the incidence of stranded contracts. During 2016, **EFET carried out a market survey on mismatched capacity at Interconnection Points** to assess the size and location of the capacity mismatch problem. Our members see us as a useful vehicle for gathering information and presenting aggregate data without revealing individual positions.

We also **advanced advocacy work on implementation of a capacity conversion mechanism at relevant Interconnection Points, which found support in ENTSOG's "Recom-**

mendation paper on issues related to bundling of capacities" issued in July 2016. The intention is to **find practical solutions on how best to bundle these capacities** to ensure that the capacity offered to the market is maximised. When unconsulted proposals were presented in the comitology process, EFET approached Member State ministry representatives directly to brief them on unintended negative consequences of the text, and **to ensure that interruptible capacity products could continue to be offered** until an effective conversion mechanism is fully implemented.

During 2016, the NC CAM was amended to include arrangements for incremental capacity. EFET worked jointly with ENTSOG to **develop solutions that reflected market-driven investment processes**. Shippers must know in advance what level of commitment in terms of price, capacity booking and booking duration is required for TSOs to be obliged to provide the incremental capacity.

Through the continuous readiness of EFET and our members, and using our collective knowledge and connectivity, we have been able to react quickly and professionally to a situation arising from an unsatisfactory process for network code amendments, which excludes network users from key steps. Based on our experiences, we will continue to press for improvements in the way that codes and their modification are designed and considered, but until then, this reinforces the importance of our ability to react quickly to unexpected changes.

References

-  [EFET Response to ACER Consultation on the Incremental Capacity Proposal and further NC CAM amendments](#)
-  [EFET-ENTSOG Joint Recommendation paper on issues related to bundling of capacities](#)
-  [EFET comments on the draft amendments to the EU Network Code on Capacity Allocation Mechanisms and the proposed Incremental Capacity Amendments](#)

"The approval of a mandatory capacity conversion mechanism in NC CAM was a success of EFET advocacy work. It will help companies to adapt their portfolios to the new world of bundled capacity without facing undue transition costs."

Andrea Bonzanni
Regulatory Advisor, EDF Trading



CAPACITY AVAILABILITY

Since the introduction of the EU Network Codes on Capacity Allocation Mechanisms (CAM) and Congestion Management Procedures (CMP), there have been a number of improvements tackling barriers related to gas transportation capacity. The introduction of coordinated times for capacity auctions, congestion management procedures such as over-selling and buy-back, and improved flow information have together significantly increased capacity availability, though this is also partly attributable to changes in the commercial environment. However, a number of implementation issues have also emerged, most notably from differences in underlying products and legislation on either side of an interconnection point, and from historical long-term agreements.

Gas tariffs and forward transparency: pushing for a pan-European approach

Over the past year, EFET has continued to contribute actively to EU discussions over harmonisation of tariff methodologies, in particular **promoting information transparency and consultation in the short term, and an industry forum for discussion of wider tariff issues** (e.g. impacts arising from stranded asset recovery, investments to meet political objectives in energy security, inter-TSO compensation payments). The **intensive advocacy of EFET alongside other industry associations resulted in an initial delay in the Tariff Network Code development process** in preference to a short-sighted compromise text which fails to address the bigger picture including more structural market problems. In the end, important improvements in transparency have been retained, and the wider issues now feature as central to the current Quo Vadis review under consideration by the Commission.

EFET has been a **recognised contributor at the Member States' "closed" decision-making forum as part of the Commission's comitology process**. From the early days of ENT-SOG's Stakeholders Joint Workshops and subsequently through direct dialogue with DG Energy officials and Madrid fora, EFET consistently supported a Tariff Network Code which provides for sufficient levels of transparency and consultation, allowing shippers to generate reasonably accurate forecasts of transportation charges, which helps to reduce risk in trading forward markets. To this end, we promoted our views at a number of industry events, including a workshop at the Florence School of Regulation on 19 February 2016, looking at the effects on tariffs of merging entry-exit zones.

EFET has advocated the need to establish a platform to develop a pan-European approach to tariffs that provides greater confidence to investors and shippers, while at the same time giving greater visibility that helps NRAs better to police the systems and encourage efficient outcomes. We are committed to playing a full and constructive role in the development of an EU Tariff Model and urge the Commission to draw upon the ambitions of Energy Union as an impetus to take this work forward.

References

 [EFET Discussion Paper on the development of a sustainable pan-EU approach to transmission charging](#)

“Our efforts will help to ensure that gas transmission tariff setting will no longer be a “black box” and that sudden and unpredictable changes in tariffs no longer eliminate arbitrage gains. But there is still work to do and policymakers need to start considering tariff setting in a pan European context for competition to continue to thrive in light of future challenges.”

Stephen Rose (RWEST)
Chair of the Tariffs Group
of the EFET Gas Committee



TARIFF NETWORK CODE

Extended discussions about possible harmonisation of transmission charging across EU Member States have revealed new insights into the kinds of risks faced by stakeholders in financing and paying for infrastructure in rapidly changing market conditions. Recent declines in consumption, ongoing changes in the profiling of gas usage, new transportation routes, and heightened desire to address supply security through interconnection pull the objectives of a tariff model in different directions.

Assessing European gas hubs: towards well-functioning gas balancing markets

In the course of 2016, EFET members carried out **the annual update of the EFET Gas Hub benchmarking scorecard**, which compares how well hubs are progressing against a best practice guide. Liquidity has improved in most of the mature hubs; developing hubs have shown a more mixed position with improvements in hub design but liquidity held back by other negative reforms; the least-established hubs are showing little sign of improvement and disappointing setbacks, particularly with regards to consultation processes – the very basic requirement for any useful stakeholder involvement.

Initial results were presented at the European Commission’s CESEC (Central and South East Europe Gas Connectivity) meeting on 29 November 2016, and EFET has been asked to support the Commission in improving the gas trading environment in South East Europe.

We are actively engaged in an ongoing exchange of views with ACER to demonstrate the impact of network code implementation on hub development and liquidity. At **a joint workshop organised on 9 November 2016 in Warsaw by ACER and ENTSOG, EFET presented the market participants’ definition of a well-functioning gas balancing market, stressing the need for accurate, near real-time system data availability.**

Work is now underway to extend the best practice model for hubs to balancing, including assessment criteria, given a high degree of overlap between good hub liquidity and the creation of a balancing market. The best practice model lays out not only an evolution of market rules that allows TSOs to progress from complete control of physical balancing to a full market-based system, but also outlines some of the preconditions for success. EFET has concerns

that Member State expectations on implementation of the Balancing Network Code are unduly optimistic, and has called for more detailed information on implementation plans, showing the steps that TSOs and NRAs will undertake.

References

-  [2015 EFET Review of Gas Hub Assessments](#)
-  [2016 EFET Review of Gas Hub Assessments](#)

“EFET annual update of the hub study regularly creates a lot of attention, both in the media and by hub operators and regulators. I think this is advocacy at its best: turning the vast expertise of the active EFET membership into a tool that regulators are willing to use as a guideline to good market design.”

Gunnar Steck (UNIPER)
Chair of the Gas Hub Development Group
of the EFET Gas Committee



EFET GAS HUB STUDY

The EFET Gas Hub benchmarking study was launched in 2014, as a means to increase consistency in gas hub design. The study explains the most important features of a hub, our view of best practice in how to establish a hub, and the optimal sequence of steps to achieve early success. The EFET hub study quickly gained positive recognition within the industry and among institutional stakeholders (ACER, the EU Commission), serving as a powerful tool to advise NRAs and TSOs of what traders look for in a hub.

Security of gas supply: testing solidarity

EFET has been instrumental in shaping the CEER-led stakeholder debate aimed at developing a pan European approach to Security of Supply consistent with good market functioning and the promotion of liquid traded markets.

Members have been directly **involved in the EU Parliamentary scrutiny process** tabling amendments to the milestone MEP Buzek report in June 2016, and continued to insist on the Commission being clear about **messages for a market-based approach at the dedicated Gas Coordination Group meetings** in Brussels. On national level, EFET-Deutschland hosted a workshop on 24 February 2016 on Security of Supply with the key opinion-formers in Berlin, emphasising the need to minimise market distortions. EFET continues to argue that **investment decisions on regulated pipelines should be based**

on the needs of market participants. Whatever path is taken for pipeline development, improved information provision by the TSOs on the usage of their pipelines is necessary to optimise the use of existing infrastructure and enable more efficient investment decisions in the future.

SECURITY OF SUPPLY

EFET has continually provided an **industry perspective on the security of gas supply proposals the Commission put forward on 16 February as part of the Energy Union's "winter package."** This follows a year of refocus and of consultation on supply security, during which EFET explained the consequences of proposals on the market through dialogue with the Commission's newly formed Security of Supply Unit and CEER, recognising that is not an absolute principle that should be mandated at any price.

The outcome appears a lot more positive. The focus of proposed amendments to the Security of Supply Regulation has moved away from a "one size fits all" model to a more behavioural approach based on regional cooperation; obligations on storage and infrastructure such as the N-1 requirement are more qualified; LNG and storage strategies recognise more explicitly the commercial realities. There now appears much more readiness to consider the risks of overinvesting in gas infrastructure or moving away from market based solutions to address security of supply concerns. EFET has also sought to advise the Commission on the complexity of invoking the solidarity principle given the lack of agreement on how a compensation mechanism (such as VoLL) might work across borders, and given prevailing political considerations in a regional emergency.

References

-  [EFET Response to EC Consultation on an EU strategy for liquefied natural gas and gas storage](#)
-  [EFET series of amendments to the draft ITRE report on the Revision of the Security of Gas supply regulation by MEP Jerzy Buzek](#)

"The market has had and continues to have a vital role to play in enhancing security of supply. New measures to promote supply security should build on market principles if they are not to have unintended consequences - EFET helps to bring this approach to the table."

Amrik Bal (SHELL)
Chair of the Security of Gas Supply Group
of the EFET Gas Committee



Spreading the market vision beyond EU borders

With a business perspective, EFET also stands ready to assist the EU Institutions' energy market integration and reform agenda beyond EU borders. On 15 July 2015, **EFET held a workshop jointly with the Energy Community, with facilitation from Naftogaz in Kiev, on the restructuring of the Ukrainian gas market.** EFET and the Energy Community convened with nearly 100 critical stakeholders to support Ukraine's commitment to implement a new gas market law, compliant with the EU's Third Energy Package.

As a partnering organisation with ICIS Heren over the past two years, **EFET has helped Petform (Turkish network user association) and the Turkish Energy Ministry to build critical know-how on the benefits of market liberalisation and gas trading,** within the framework of an EU-funded project which came to a close in mid-2016.

Whilst grand energy alternatives might still be years away, Turkey should look into strategic transformation to put in place a transparent, competitive market structure, building on positive European experience.

In the context of a Strategic Energy Dialogue with Algeria, the Commission requested **EFET assistance in sharing expertise with Algerian authorities to help facilitate market reform and increased participation in the EU gas market.** In cooperation with the EU Commission, EFET held a training workshop for the Algerian delegation on 11-13 July 2016 to explain the path from long-term oil-linked contractual arrangements towards hub-based pricing and benefits of transparent market conditions.

INITIATIVES WITH UKRAINE

EFET management has featured among top discussion-leaders in the launch 2015 edition and 2nd Ukrainian Gas Forum in October 2016 in Kiev, aimed at facilitating the roll-out of the unbundling process and implementation of market mechanisms in the Ukrainian gas sector, as Ukraine reached out to its European partners. The Energy Community has requested EFET assistance in identifying possible improvements and has offered support in promoting relevant changes.

"It is increasingly important to be able to give feedback to policymakers about the impact of their decisions on real markets. EFET provides an invaluable vehicle to bring this experience into the debate."

Doug Wood
Chair of the EFET Gas Committee



Outlook for 2017

With much of 2016 spent on finalizing the design of the remaining network codes, the focus in 2017 will move towards their implementation. As national interests seek to interpret the codes in ways that meet local concerns, significant EFET coordination will be important to ensure they are effective, transparent and work in a harmonized way to promote cross-border trading. In particular, **the introduction of the Network Code on Balancing in developing markets will be crucial to promote liquidity.**

The European Commission has embarked in a study Quo Vadis to help identify the next priorities to be addressed. We have promoted a review of contractual conditions, capacity holdings and transportation pricing at interconnection points, with implications for revenue recovery among TSOs, as critical to ensure further development of the gas market.

Security of Supply remains at the forefront of European and national considerations for the internal gas market. Interaction between the proposed new Regulation on Security of Supply and market rules being implemented must be properly considered to avoid negative unintended consequences. Incentives for infrastructure investment and access rules to LNG and Storage facilities are also expected to be under review.

Market Supervision

KEY OBJECTIVES AND ACHIEVEMENTS

In response to the financial crisis of the late 2000s, we have experienced a complete overhaul of the European frameworks for the regulation of financial and energy markets and an extension of financial market regulation to commodities markets, including energy markets. In the course of this development, our goal has been to ensure a robust regime for the integrity and transparency of wholesale elec-

tricity and gas markets under the Regulation on Wholesale Energy Market Integrity and Transparency (REMIT) and to minimize the negative impact of extending the financial market regulatory framework to energy firms and energy trading. The past year has been critical, as key rules have entered final stages of development, while others have been adopted and implementation work has commenced.

Introduction

The EFET Market Supervision Committee (MSC) meets on average around seven-nine times per year. Most MSC Working Groups (WGs) arrange regular conference calls instead of physical meetings. The Committee monitors closely regulatory and policy developments in the field of financial regulation, which impact commodities trading, as well as market integrity and transparency rules specific to energy markets and energy trading firms. It is responsible for defining objectives and for agreeing a strategy and actions to achieve those objectives. The agreed actions are implemented by dedicated WGs, including the MiFID WG, EMIR WG, Capital WG, Market Integrity and Transparency (MI&T) WG, and Operational Regulatory Reporting (ORR) WG. Occasionally, ad hoc WGs are also set up to deal with a specific issue outside the remit of the abovementioned WGs, such as the current Securities Financing Transactions Regulation Working Group (SFTR WG). About 25 active members attend regularly MSC and WG meetings and conference calls.

We engage with policy-makers and regulators through bilateral meetings, regular submissions to consultation processes, voicing our concerns at public hearings and roundtables, and participating in expert group meetings and industry forums. Our main counterparties are the agency of European financial regulators -European Securities and Markets Authority (ESMA); the Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) of the European Commission; the agency of European energy market regulators - Agency for the Co-operation of Energy Regulators (ACER); and the agency of European prudential supervisors -European Banking Authority (EBA). We are also often in contact with national financial and energy regulators, and prudential supervision authorities.

We have formed successful continuous and ad hoc alliances with various industry associations. Eurelectric, Eurogas, Energy UK, BDEW, and IOGP are our regular partners within the framework of the Joint Energy Associations Group (JEAG), which is stirred by EFET. We are also members of the Commodity Derivatives Working Group (CDWG), together with ISDA and FIA Europe. Europex is also a frequent partner.

MiFID II: promoting the development of an appropriate ancillary activity exemption framework

Ensuring the development of an appropriate ancillary activity exemption framework under the recast Markets in Financial Instruments Directive (MiFID II) has been a priority for the MSC, as financial regulators' proposals threatened to damage seriously the liquidity of energy markets in Europe. In the course of over a year, we **pushed for the re-introduction of a capital-based test** – a test that is better able to reflect the nature and business model of asset-based energy firms – in addition to the main business test proposed by the European Securities and Markets Authority (ESMA) to determine ancillary activity. **We forged alliances with a number of industry associations across Europe and issued a series of joint statements raising awareness of the potential risks and implications of a poorly designed exemption framework.** In the end, we succeeded in bringing the issue high on the agenda of DG FISMA.

On 1 December 2016, together with the Regulatory Technical Standards (RTSs) specifying the MiFID II position limits regime (RTS 21), the European Commission published the RTSs (RTS 20) detailing the ancillary activity exemption framework. A capital employed test was re-introduced as an additional option to ensure that the main business test is more indicative of the main business activities of groups with significant capital investments in infrastructure or production facilities or with investments, which cannot be hedged easily in financial markets.

We welcome in principle the re-introduction of a capital-based test, the details of which we are now in the process of analysing. We are also supportive of the decision of the European Council not to object to the proposed rules (27 January) and of the recent vote of the European Parliament against motions to reject RTS 21 (15

February). This de facto adoption of RTS 21 and RTS 20 (against which no motions for rejection were brought forward) means that there will be no further implementation delays. This would help market participants and regulators to proceed with preparations for the new regime (due to start applying on 3 January 2018) with greater confidence and certainty.

Adopting a well-calibrated ancillary activity exemption framework under MiFID II is essential, as the framework would determine whether a company would require authorization as an investment firm under MiFID II. MiFID II authorization, in turn, makes a company subject to the capital adequacy regime under the Capital Requirements Regulation (CRR) and the related fourth iteration of the Capital Requirements Directive (CRD IV).

Background

BACKGROUND ON MiFID II RTS 20

MiFID II and the related to it Regulation – MiFIR, were published in the Official Journal of the European Union on 12 June 2014. Their provisions will start applying as of 3 January 2018 when they will replace MiFID, which is currently in force. The new regime extends the regulatory framework to new products and trading venues with a view to improving market stability and enhancing investor protection. Thus, while MiFID contains a qualitative exemption for persons whose main business consists of dealing on own account in commodities and/or commodity derivatives (MiFID I, Art. 2(1)(k)), MiFID II introduces a quantitative exemption from MiFID II licensing requirements **for companies whose trading in commodity derivatives, emission allowances and derivatives of emission allowances is only ancillary to their primary commercial business** when considered on a group basis (MiFID II, Art. 2(1)(j)). On 28 September 2015 ESMA, submitted to the Commission a draft RTSs, proposing a way in which this quantitative assessment is to be carried out. The draft included two related tests: a main business test and a trading activity test. In the spring of 2016 the Commission informed ESMA that they shall adopt the draft RTSs only after certain changes were made, including the re-introduction of a capital employed test. A capital employed test was developed by ESMA in an earlier draft of the RTSs, but was later dropped and replaced by a proxy test – the main business test, following concerns that the test may be difficult to calculate and that it may be prone to manipulation. In its request for amendments the Commission asked ESMA to propose a methodology for a capital employed test, which is robust and addresses the concerns raised around the earlier version. In response, ESMA offered several design options. The Commission used those in deciding on the final version, which has now been adopted by the Parliament and the Council.

References

-  [JEAG letter on MiFID II](#)
-  [Joint letter to Cabinet of Commissioner Hill on MiFID II](#)
-  [EFET response to EC call for evidence on EU regulatory framework for financial services](#)

“We put considerable effort to ensure that the ancillary activity exemption framework under MiFID II is well-designed and we welcome the decision of the Parliament and the Council not to object to the Commission proposal for RTS 20.”

Karl-Peter Horstmann (RWEST)
Chair of the
EFET Market Supervision Committee



Capital requirements: ensuring a well-calibrated prudential supervision regime for commodity firms

We have successfully brought to the attention of the Commission and the European Banking Authority (EBA) the need for a differentiated treatment of commodity firms under a revised European capital adequacy regime.

We contributed to ensuring that commodity firms authorised under MiFID II will remain exempt from own funds requirements and will continue to be subject to the transitional provisions for large exposures under the Capital Requirements Regulation at least until 2020.

Furthermore, the Commission has invited the EBA to look into the potential design of a new regime for non-systemic commodity firms under the current review of the capital requirements framework. We have started contributing to the analysis undertaken by the authorities to ensure that the applicable regime will reflect

the business models and risk profiles of specialised commodity firms and that it will not impose undue burdens on our sector.

To this end, **we met with EBA officials and took part in related roundtables on several occasions over the past year.** On February 2 we also submitted a comprehensive response to an EBA Discussion Paper, which outlines the authorities' initial ideas for a new prudential supervision regime.

REVIEW OF THE CAPITAL REQUIREMENTS REGIME

The Capital Requirements Regulation (CRR) requires the Commission to carry out a review of the prudential supervision regime applicable to investment firms. The Commission launched the review process with a request for technical advice from the EBA and ESMA.

On 15 December 2015, the EBA responded to the Commission with a report containing three recommendations: 1) a proposal for a three-fold categorisation of investment firms: i) systemic and 'bank-like' investment firms to which the full CRD/CRR requirements should be applied; (ii) other investment firms ('non-systemic') with a more limited set of prudential requirements; and (iii) very small firms with 'non-interconnected' services; 2) a recommendation for further analysis of the prudential requirements of category 2 and 3 firms; 3) and a recommendation for extending the exemptions for commodity firms under Articles 493 and 498 of CRR until 2020. Following a second call for advice by the European Commission, based on the abovementioned recommendations, the EBA is now carrying out an analysis of category 2 and 3 firms, including commodity firms, with a view to developing quantitative indicators for determining eligibility and calibrating appropriate prudential supervision regimes for each category. On 4 November 2016, the EBA issued a **Discussion Paper (DP)** outlining their initial thoughts on how to design and calibrate a new regime for the different categories of investment firms. The final report is expected to be completed by the end of June 2017.

References

 [Joint EFET-FIA Europe-ISDA paper on the potential impact of capital requirements for commodity firms from 2015](#)

“Our intent is to support the European Commission and their technical advisors (EBA and ESMA) in accurately assessing the risks posed by commodity dealers whom are presently or may become authorised under MiFID. Only once this is done can a proportionate prudential requirements regime be implemented for January 2021.”

Ian Mulligan (BP)

Chair of the Capital WG of the
EFET Market Supervision Committee

EMIR: contributing to the EMIR review to help improve the regulatory framework

Over the past year, we have seized the opportunity to contribute to the review of the transparency and risk mitigation regime for OTC derivatives under the European Market Infrastructure Regulation (EMIR) and related technical standards and non-binding guidelines.

Since the launch of the EMIR review last year, we have met the Commission three times – in November 2015, May 2016 and January 2017 – **to present our concerns and recommendations for improvements in view of the experience gathered with the regime.** Our Market Supervision Committee and dedicated EMIR Working Group (WG) have advocated the review of aspects of EMIR in view of related developments, such as MiFID II; **we have emphasized the need to remove undue operational burdens; and we have highlighted that the proposal of ESMA to delete the hedging exemption is not based on robust analysis and could have very harmful implications if implemented.**

Further meetings with DG FISMA are planned. In parallel, we also contributed to the development of the implementing rules on margining and on two occasions we provided input to technical inquiries from ESMA in relation to aspects of the new implementing and regulatory technical standards (ITSs and RTSs) on reporting.

REVIEW OF EMIR

The EMIR review was launched by the European Commission with a consultation, which closed on 13 August 2015. Later on in the year, the Commission launched a related consultation on the overall framework for financial regulation (the consultation closed on 31 January 2016). The responses to these two consultations were used in the development of the Commission report on the EMIR review published in December 2016. Legislative proposals for amendments to aspects of the EMIR framework are expected in the first half of 2017.

References

 [EFET response to the European Commission consultation on the EMIR review](#)

 [EFET press release on the EMIR review](#)

“Our goal is to ensure that aspects of the EMIR framework are reviewed in view of related regulatory developments, that unnecessary burdens on non-financial firms are removed, and that reporting is simplified and clarified.”

Cemil Altin (EDTF)
Vice-chair of the
EFET Market Supervision Committee



MAR: obtaining clarity and regulatory certainty

In relation to the rules for the detection and prevention of market abuse under the Market Abuse Regulation (MAR), **we succeeded in ensuring that disclosure channels for inside information under REMIT are considered sufficient for compliance with the disclosure requirements for emission allowance market participants under MAR.**

We also contributed to the incorporation of the principle of proportionality in relation to the obligations on market participants to detect and report suspicious transactions and orders under MAR, in co-operation with the Trading Compliance WG of the Legal Committee. We achieved those through a number of written submissions and by highlighting the issues at bilateral discussions with regulators.

MAR

The framework for the prevention of market abuse in financial markets under MAR started applying on 3 July 2016. The package of implementing rules has now also been completed with only third-level guidance still being issued by ESMA. Most notably, on 30 June 2016, the Implementing Regulation on means for disclosure of inside information under MAR was published in the Official Journal of the European Union. According to the new rules, emission allowance market participants (EAMPs) will not suffer additional burdens when complying with the obligation to disclose inside information. Disclosure obligations shall be considered to be fulfilled where the information is disclosed through the technical means established under REMIT, provided that the information has substantially the same content. **In addition, on 30 May 2016, ESMA published brief guidance on the scope of application of the obligations to detect and report suspicious transactions and orders (STOR) under Article 16(2) of MAR, confirming that the definition of ‘person professionally arranging or executing transactions’ (PPAET) laid down in point 28 of Article 3(1) of MAR applies broadly and that it includes ‘firms professionally engaged in trading on own account (proprietary traders).’ This means that non-financial firms trading on own account will need to maintain ‘effective arrangements, systems and procedures to detect and report suspicious orders and transactions’.** The EC Delegated Regulation on surveillance systems and STORs published in March introduced an element of proportionality by stating that such arrangements, systems and procedures should be ‘appropriate and proportionate in relation to the scale, size and nature’ of the firm’s business activities. Their appropriateness, however, will have to be demonstrated, if requested by regulators.

REMIT implementation: resolving remaining data reporting challenges

In relation to the rules for the detection and prevention of market abuse under the Market Abuse Regulation (MAR), **we succeeded in ensuring that disclosure channels for inside information under REMIT are considered sufficient for compliance with the disclosure requirements for emission allowance market participants under MAR.**

We also contributed to the incorporation of the principle of proportionality in relation to the obligations on market participants to detect and report suspicious transactions and orders under MAR, in co-operation with the Trading Compliance WG of the Legal Committee. We achieved those through a number of written submissions and by highlighting the issues at bilateral discussions with regulators.

“We have established a good working relation with ACER with regard to REMIT implementation and will aim to maintain this co-operation in the future.”

Filip Sleeuwagen
Former chair of the EFET Transaction Reporting Working Group



REMIT

REMIT was put in place to strengthen the integrity and transparency of wholesale energy markets. It has been in force since 28 December 2011. The provisions on data reporting, however, started applying at a later stage: on 7 October 2015 for standard contracts concluded on organised market places; and on 7 April 2016 for non-standard contracts concluded outside venues. Data collection is now going relatively smoothly and the ACER is shifting its focus towards more active market monitoring.

Outlook for 2017

A lot is at stake when it comes to the ancillary activity exemption framework under MiFID II and at the start of the New Year **we will focus on examining carefully the adopted methodology and on assessing its implications. Work on related issues, such as the implementation of the position limits regime under MiFID II** will also continue.

We will step up **our involvement in the review of the EU capital adequacy regime** under CRR and the fourth iteration of the Capital Requirements Directive (CRD IV), as the review process is an important opportunity to ensure that the prudential supervision regime applicable to commodity firms authorised under MiFID II is appropriate, i.e. that it is designed by taking into account the nature of their business model and their risk profile.

In the coming year, we will **continue our engagement with the Commission and other relevant parties in relation to the on-going review of EMIR** to ensure that existing inefficiencies are addressed and that undue burdens on non-financial firms are removed. We shall also **continue our cooperation with ACER and national regulators in relation to REMIT implementation** for the smooth functioning of the data reporting regime. Although market abuse prevention under both REMIT and MAR has now largely moved from the external advocacy sphere to the internal individual firm's compliance realm, the MSC will continue to **monitor the implementation process**. We remain ready to engage with regulators, should there be further consultations on additional guidance or proposals for improvements of the two regimes.

Contractual Standardisation and Legal Support

Introduction

EFET has since 1999 provided widely accepted and reliable contractual standards for physically settled wholesale energy transactions in Europe. The work we do on standard master contracts for use especially in OTC power and gas markets is coordinated by the EFET Legal Committee.

The Legal Committee convenes representatives from around fifty companies with regular EFET membership and from around thirteen with associate membership. These companies subscribe to what we call a Legal Module within EFET. The Committee coordinates the drafting and modification of the master documents and various annexes allowing variations in their application, together with the procurement of common legal opinions related to them, through a series of working groups and sub-committees. These groups collectively drive the EFET contractual standardisation agenda, and steer work on other issues of concern to in-house counsel within the energy trading community. In 2016, they included the following Task Forces (TF) and Working Groups (WG):

- TF Area D Gas Appendix
- TF German Insolvency Law Reform
- TF Italian Netting Law
- TF VAT / Tax Issues
- TF French Capacity Certificates Appendix
- WG Credit
- WG Trading Compliance
- WG Collateral

Since its inception the Legal Committee has developed and issued an extensive library of EFET standard documents aimed at facilitating OTC transactions in energy as a commodity and in energy-related instruments. These documents have become the most widely used standard master agreements in Europe for trading wholesale physical electricity and natural gas, carbon emission allowances, and green EECs certificates.

The greatest challenge in developing standard documents with this level of flexibility is ensuring they are legally enforceable in each of their potential permutations and combinations of users, uses and legal systems. For this reason,

we have commissioned and maintained through regular updates legal opinions on the enforceability in multiple jurisdictions of key provisions of each master contract. The most notable recent achievement in this respect has been the procurement of opinions confirming the recognition of close-out netting in counterparty insolvency scenarios.

The Legal Committee also procures opinions in the context of more general requirements of in-house trading company counsel for legal interpretation. For example recently the legal memoranda have been procured in relation to interpretation of crucial provisions of MIFID II.

Advocacy efforts to reform and adapt national laws

The Legal Committee during 2016 steered a number of advocacy initiatives to introduce netting laws for physically settled transactions, and thereby diminish collateral pressures on companies trading in some key national jurisdictions. Such an initiative has proved especially successful in Germany. The outcome of our advocacy in Italy is currently pending.

ITALY

We put forward **a text providing for statutory recognition of close-out netting in insolvency scenarios** in a pending piece of primary legislation aimed at enhancing the competitiveness of the Italian economy (a new Competition Act).

The draft Competition Act may be tabled for decision in 2017. If enacted, the recognition of netting in the Insolvency Act, as amended by the new law, will substantially reduce collateral requirements for many trading companies with an establishment in Italy. So far, many Italian trading companies have had to post higher collateral compared to companies established in other EU member states, as close-out netting in insolvency cases was excluded in Italian insolvency law. The high netting risk translated into higher collateral requirements, which in turn have impaired trading liquidity.

GERMANY

EFET in the course of 2016 **stimulated the reform of the German Insolvency Code by increasing the understanding of key trading issues on the part of officials and legislators in Berlin**. EFET took the lead role in a group of like-minded associations aiming at a clarification of the scope for close-out netting in the German Insolvency Act. An insolvency reform law has entered into force after publication in January 2017. The new insolvency reform law brings clarification to the trading community regarding the statutory recognition of close-out netting, following a series of less clear Supreme Court rulings. The amendment of the Code puts the validity of contractual netting arrangements beyond doubt and thus will lower a crucial element of operational costs for OTC energy commodity trading.

Background

ITALIAN DRAFT LAW

The draft Competition Act was voted through by the Industry Committee of the Senate in early summer 2016 and it was later passed to the Senate in plenary session. The close-out netting amendment is now contained in article 38, paragraphs 7 and 8. The deadline for tabling amendments to the draft law in the plenary session expired on 12 September 2016 and no amendments have been made. The Plenary of the Senate was expected to endorse the draft until the government lost the referendum it had called on constitutional reform. The ensuing resignation of the Prime Minister stopped the legislative process in December 2016.

GERMAN INSOLVENCY CODE

In June 2016, the Supreme Court issued a ruling providing for the non-enforceability of a contractual netting arrangement in the context of a derivative standard contract issued by the Association of German Banks. This ruling brought about increased pressure to clarify the applicable law, and we were able to take advantage of the situation to press for clarification regarding the status of wholesale gas and electricity master contracts. Not only are exposures from these contracts now nettable upon insolvency, but also the revised Insolvency Code has created additional flexibility, allowing counterparties to deviate from statutory provisions in their own netting agreement.

Contractual standardisation achievements

With the full implementation of the REMIT reporting regime, the Committee has developed a **contractual standard for the industry to serve the interest of energy sector regulators in gathering data about physical wholesale market transactions.**

Over the past year we have been working on developing a standard contract for trading flexible gas storage. The Committee has furthermore worked on modifying hub documentation for gas trading hubs.

• **Non-OMP REMIT Reporting Agreement** The standard reporting agreement for phase II of REMIT delegated reporting of transactions other than by Organised Market Participants was published [on the EFET website](#).

• **Virtual Storage Individual Contract** The standard Individual Contract, [published in June 2016](#), is to be used for trading of flexible gas storage.

• **UK Beach (6:6) Appendix** [In June 2016 we published](#) a new version of the EFET Beach Appendix for those Beach sub-terminals that have retained the 6:6 gas -day.

• **PVB Appendix** In the light of numerous changes in the gas balancing rules in Spain and their material impact on the terms of the EFET AOC Appendix from September 2013, we developed a new PVB (Punto Virtual de Balance) Appendix. The PVB Appendix was [published on 19 September](#) on the EFET website.

• **Appendix for French capacity market certificates** In December 2016, we [published an Appendix](#) that covers the capacity trade commencing in December 2016 after the EU Commission clearance of the French capacity market.

Setting best practice for back office operations and regulatory compliance

Within the EFET Trading Compliance Group, numerous experts of a compliance, credit risk and/or legal background exchange **best practice on the interpretation and understanding of abusive practices and the implementation of trading surveillance systems under MAR**. On 23 and 24 November 2016, **the Group organised a workshop on MAR market surveillance and enforcements trends** in London, which saw a positive recognition of the industry representatives and helped building a critical know-how in the priority compliance area.

Moreover, the EFET Collateral and Credit Groups **have progressed the work on the update of the EFET Credit Risk Manual and the accompanying annexes**, which are to serve as a comprehensive and detailed overview for new staff

Legal support services

The reliability of our Standard Master Contracts has been supported by the generation of multiple legal opinions taking account of new case law, related for example to the prevalence of supply turbulence or to the eventuality of insolvency of a market participant. In the course of 2016, we published new versions of our legal opinions assessing the enforceability of the two main EFET General Agreements (for gas and power) in more than 20 European jurisdictions as well as in Turkey, the USA and Ukraine.

In addition, **we have developed an EFET Document Ratification System (“EDRS”) as an industry body for the purposes of assisting market participants to ratify EFET standard contracts**. This new system provides market participants

with an online-based solution enabling parties swiftly to transition from one version of an EFET published document to another. In 2016, two new documents were added to the EDRS for online ratification: a Ratification Letter for Amendments to the EFET AOC Appendix (Version 1.0/23 September 2013) and a Ratification Letter for the EFET PVB Appendix (Version 1.0/19 September 2016). In total, 13 documents are currently open for online ratification via EDRS. [The platform is available](#) to non-EFET members as well as our member companies and its use is free of charge.

Outlook for 2017

Building on success stories in **improving the close-out netting prospects for EFET member companies** in Italy, Slovenia and Germany, the Legal Committee will continue to undertake advocacy initiatives aimed at promoting close-out netting and insolvency protection reforms in Croatia and Serbia. With power trading becoming more widespread in South-East Europe, it is time for EFET to raise the need for recognition of close-out arrangements under national insolvency laws.

With Brexit high on the industry agenda, the Legal Committee will further explore the required scope of contractual changes, starting with the **EFET green certificate contracts**. These normally contain a long compliance period. More detailed work will be undertaken, once the terms of Brexit take shape.

Since MiFID II “go live” is soon approaching, the Legal Committee will **continue to support the work of the dedicated MiFID and market transparency groups** established under the Market Supervision Committee. We will aim to help achieve legal certainty on some of the outstanding issues of the recent financial regulation reforms, foster a common industry understanding of what they entail, and facilitate engagement with trading platform operators and other stakeholders. The Trading Compliance Work Group will further deepen its expertise in addressing market integrity related obligations and anti-abuse enforcement (e.g. under MAR and REMIT). Training initiatives for senior compliance/ legal/ risk management/ regulatory colleagues are likely to continue throughout 2017. They will be suggested for any managers, who deal with potential cases of market abuse and investigations within their own companies.

Brexit

In the light of the UK's decision to leave the European Union, the EFET Board decided in August 2016 **to establish a sub-committee of the Board to work on "Brexit"**.

The main role of the sub-committee is to follow the preparation of positions by the British government and by EU institutions and, as from April 2017, to track negotiations. The sub-committee is expected to keep the Board and membership updated on implications for European wholesale power, gas and emissions markets and develop thinking about what aspects of the EU regulatory 'rulebooks' governing energy transactions should be retained in a future UK legislative and regulatory framework.

The sub-committee has already started to engage with relevant UK industry associations and institutions to explore the consequences of Brexit and possible co-ordination of public statements. **We have in addition completed early EFET submissions** urging policymakers to avoid future jeopardy to cross-border transactions; to discourage them from using wholesale

energy market access as a hostage in Article 50 negotiations; to maintain a common European energy market which includes the UK; and to pursue continued UK participation in the EU ETS.

Two briefing notes are in preparation for use by EFET main committees and individual member companies, one dealing with preferred outcomes of Brexit for the energy markets from a UK perspective and a similar one from an "EU 27" perspective. We expect the elaboration of detailed positions and advocacy strategies, concerning impacts on the power market, on the gas market and on derivatives markets, then to proceed within the appropriate EFET main committees.

In parallel, a Brexit questionnaire has been sent to all member companies, in order to help the sub-committee build a more comprehensive list of corporate concerns and objectives, for possible consolidation within EFET advocacy activities.

"The UK's decision to leave the EU presents a range of significant practical and political challenges to the wholesale energy markets. The Brexit sub-committee of the EFET Board will play a valuable role in reminding the EU and UK Government of the economic benefits of efficient and secure cross-border trade in energy and in framing the practical steps required to ensure a smooth exit and transition."

Paul Dawson (RWEST)
Chair of the EFET Board



HIGHLIGHTS



Oct. 2016
Sarajevo

Filip Sleuwagen (EFET) speaking about REMIT at EFET workshop on wholesale energy trading



Nov. 2016
Amsterdam

Jérôme Le Page (EFET) moderating panel on renewables at EMART



Nov. 2016
Amsterdam

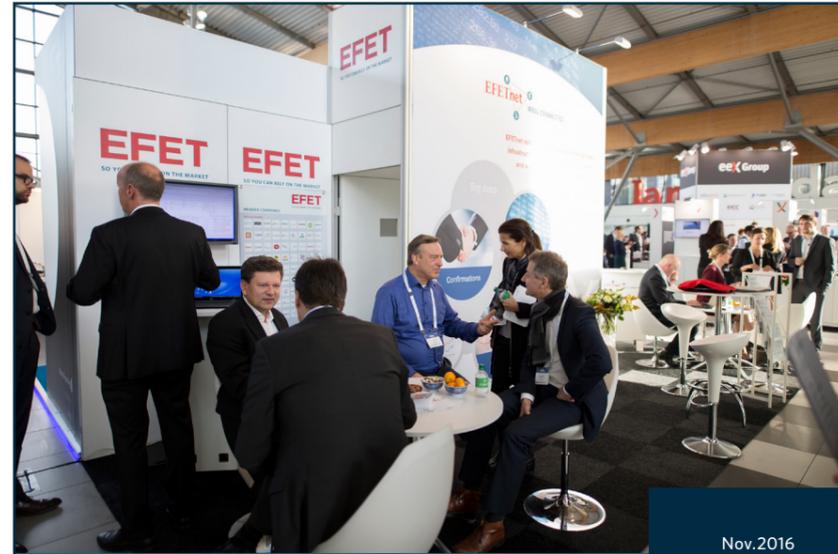
EFET press conference at EMART



Oct. 2016
Brussels

Peter Styles (EFET) talking about the challenges the wholesale sector is facing at EPEX Summit

HIGHLIGHTS



Nov. 2016
Amsterdam

EFET stand at EMART



July 2016
Brussels

EFET gas workshop for Algerian delegation at the European Commission



May 2016
Zagreb

EFET workshop on wholesale energy trading



Oct. 2016
Kiev

Jan Haizmann (EFET) speaking at the Ukrainian Gas Forum

HIGHLIGHTS



June 2015
Budapest

Doug Wood (EFET) at a panel discussion at ETCSEE conference

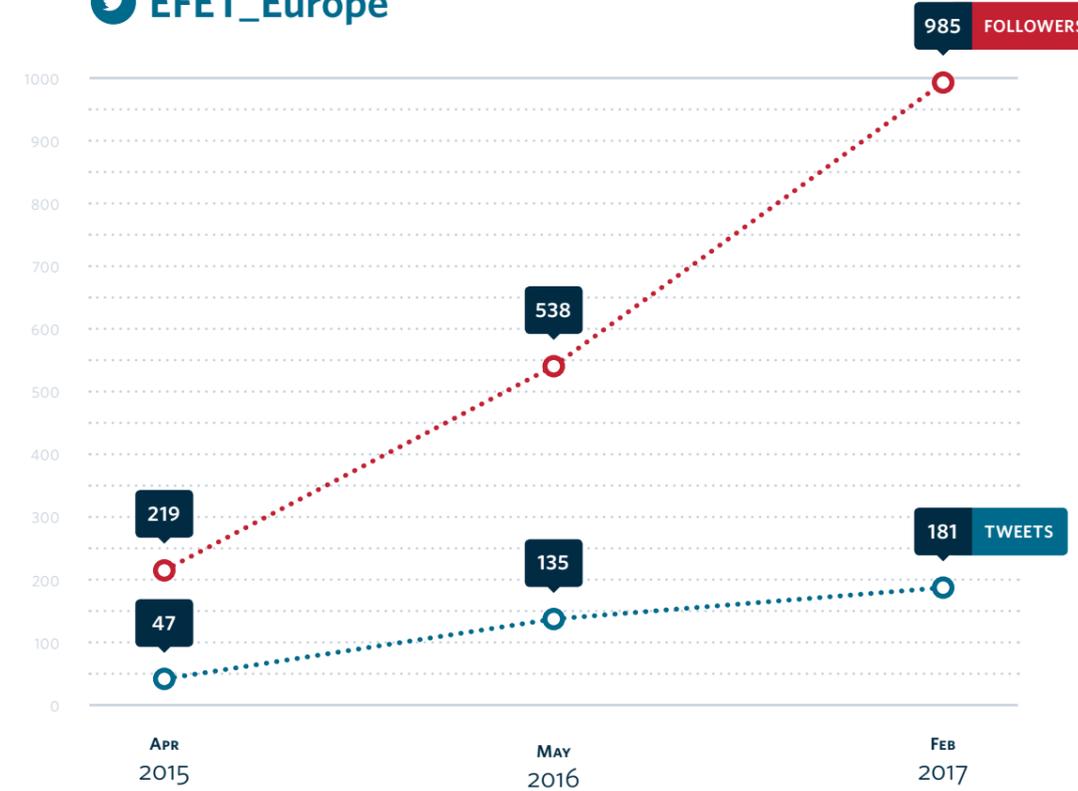


June 2016
Sofia

Doug Wood (EFET) speaking about the Internal Energy Market at GIE annual conference

SOCIAL MEDIA

EFET_Europe



EFET ACADEMY

Energy Markets Training Programme

The EMTP is an easily-accessible, web-based, training programme designed to assist energy company staff to understand the complexities of energy commodity markets.

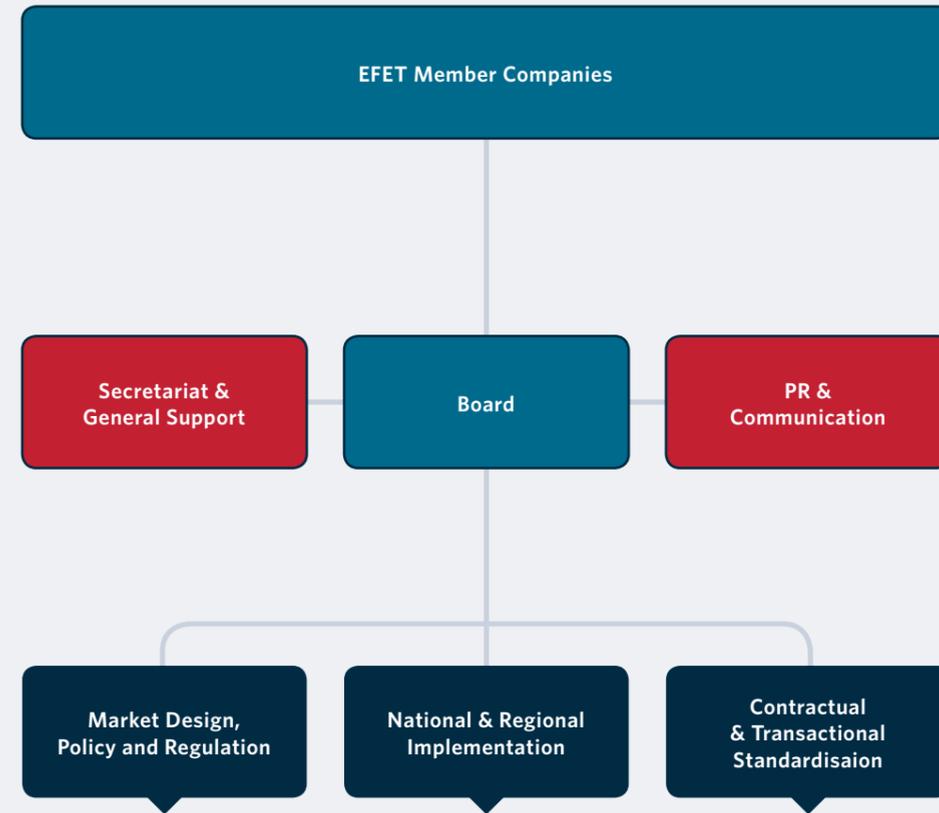
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