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**European Energy Regulators' response to the European Commission's public  
consultation on "A revision of the Market Abuse Directive (MAD)"  
29 July 2010**

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## **1 Introduction**

In December 2008 the CESR/ERGEG advice to the European Commission recommended a sector specific tailor made market abuse regime be put in place including greater transparency of fundamental data (price sensitive information, e.g. power plant outages) and for trading data (anonymous publication of transactions close to real-time).

The European Regulators' Group for Electricity and Gas (ERGEG) welcomes the possibility to comment on the planned revision of the Market Abuse Directive (MAD). In the following contribution we focus on issues related to commodity derivatives (esp. questions 1 and 4 of the consultation) as electricity and gas trading may be affected by such a revision.

ERGEG has already previously been engaged in the discussions on how to secure market integrity in energy trading. In December 2007, CESR and ERGEG were mandated by the European Commission to provide an advice on issues related to market abuse in the energy sector and the two regulatory groups submitted their advice in October 2008<sup>1</sup> after thorough considerations and extensive stakeholder consultation.

Energy and financial regulators noticed and underlined in their advice that the current Market Abuse Directive (Directive 2003/6/EC) only partly covers energy markets as it is designed for financial markets. MAD applies almost exclusively to financial instruments admitted to trading on a regulated market. Physical products (e.g. spot market products) are not covered and derivatives market products are covered only if they are admitted to trading on a regulated market. Thus, energy and financial regulators recommended in their advice a sector specific regime for electricity and gas trading.

ERGEG maintains the view that a sector-specific regime is the best solution to prevent market misconduct in the energy sector. Energy regulators should assume a key role in this regime given the need for a real understanding of the functioning of energy markets to detect market misconduct and their responsibility to design the access to these markets.

It is important to note that electricity and gas trading is very different from trading of other commodities or financial products. One main difference is that electricity is not storable and storing gas is very costly or sometimes no storage infrastructure is available. Secondly, energy trading depends to a large degree on the availability of transport facilities (network infrastructure). Thus, there are certain risks of market abuse behaviours that exist uniquely in the energy sector (e.g. energy trading is vulnerable to the risk of capacity withholding) which suggests to apply a sector specific regime.

For this reason DG ENER has published a consultation paper on measures to ensure transparency and integrity of wholesale markets in electricity and gas. As mentioned above, ERGEG maintains the view that such a sector-specific regime is the best solution to prevent market misconduct in the energy sector<sup>2</sup>. Thus, ERGEG recommends that the results from DG ENER's consultation should be considered properly when reviewing the provisions related to commodity derivatives within MAD. Energy regulators consider it therefore crucial that policy initiatives which could impact energy markets are consistent.

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<sup>1</sup> Market Abuse. CESR and ERGEG advice to the European Commission in the context of the Third Energy Package, Ref. E08-FIS-07-04, October 2008, [http://www.energy-regulators.eu/portal/page/portal/EER\\_HOME/EER\\_PUBLICATIONS/CEER\\_ERGEG\\_PAPERS/Cross-Sectoral/2008/E08-FIS-07-04\\_%20MAD%20Advice.pdf](http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Cross-Sectoral/2008/E08-FIS-07-04_%20MAD%20Advice.pdf)

<sup>2</sup> For more details see the ERGEG response to the European Commission's public consultation on the "Initiative for the integrity of traded energy markets", Ref. C10-GA-62-04, July 2010, [http://www.energy-regulators.eu/portal/page/portal/EER\\_HOME/EER\\_PUBLICATIONS/CEER\\_ERGEG\\_PAPERS/Cross-Sectoral/2010/C10-GA-62-04\\_EC%20Market%20Integrity%20PC\\_21-Jul-2010.pdf](http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Cross-Sectoral/2010/C10-GA-62-04_EC%20Market%20Integrity%20PC_21-Jul-2010.pdf)

## 2 Comments on the MAD revision

The following comments on the MAD revision are based on the assumption of a sector-specific tailor-made market abuse regime covering the whole energy market and creating a single EU-wide harmonised regime for this market as proposed in the above-mentioned advice by ERGEG and CESR in October 2008 and recently reaffirmed in ERGEG's comments to DG ENER's consultation on measures to ensure transparency and integrity of wholesale markets in electricity and gas from 31<sup>st</sup> May 2010.

When looking at misbehaviour, experience shows that market abuse is not limited to certain products. As Ms Sharon Bowles stated at the Commission hearing on the MAD revision (2 July 2010) "market abuse relates to behaviour not to products". Thus, any legal regime and oversight activity for electricity and gas trading has to cover the entire wholesale market – the physical and financial markets, the spot and the derivatives markets, over-the-counter and exchange trading. The authority responsible for the supervision of the market has to have access to all relevant transaction information in the whole market. Thus, to protect market integrity in electricity and gas trading, it would not be sufficient to enlarge MAD's scope to MTFs only, as energy is traded prevalently on unregulated markets and OTC and all market segments are closely linked. Instead, electricity and gas trading should be subject to a sector-specific regime which includes all relevant products, market participants and trading venues.

The need for a sector-specific regime was confirmed by the panellists of the hearing on the revision of the MAD (2 July 2010). Such a sector-specific regime should also include a definition of inside information for electricity and gas trading. Keeping the current commodity-specific definition as well as aligning the definition of inside information for commodity derivatives with the general definition as proposed in the consultation paper would be difficult.

Energy regulators are of the view that the definition of inside information in the sector-specific regime for electricity and gas trading should take account of the specificities of electricity and gas trading, as market misconduct may be related to physical fundamentals (generation withholding in the case of electricity, for instance). Furthermore, the publication should not only be related to the "issuer" (as currently done in the MAD) as the relevant information in

electricity and gas trading is held by others, e.g. power plant operators, transmission system operators. It is not the issuer of a specific product or instrument who may have inside information as there is no such issuer in the electricity and gas markets. This demonstrates that there is a need for a sector-specific definition of insider information and the obligation to publish this information in a systematic and standardised manner. This was also underlined by the panellists of the hearing on the MAD revision. The representative of a financial regulator expressed at the hearing the view that a simple adaption of the rules for the financial markets would not contribute to more market integrity in these markets and confirmed that insider dealing in the commodities markets and in the financial markets needs different rules.

The importance of a sector-specific regime for the energy sector has to be seen in the context of a rapidly growing energy market. Energy trading including emission allowances, coal and oil markets, will gain further importance in the near future, since wholesale market volumes are increasing. Trading provides good opportunities for hedging which is crucial for numerous market participants in order to ensure price predictability. This is especially true for the rapidly increasing amount of small and medium sized companies, as e.g. municipal energy suppliers, entering into energy trading in order to gain competitive advantages. In the course of the EU attempt to increase the production of electricity from renewable sources, on the promotion of the use of energy from renewable sources, the amount of renewable energy traded on the energy market will also increase significantly. This will lead to higher trade volumes, more traders and most likely a higher volatility of energy prices. Thus, the integrity of the markets will become more and more important.

Energy regulators know that the question of surveillance is also a political one. Any supervisory structure has to take into account the Almunia proposals and experiences in other jurisdictions, e.g. in the United States. Nevertheless, energy regulators are ready to contribute actively with their existing expertise to ensure market integrity.

Especially the question of transparency of all types of wholesale transactions seems to be crucial in this context. In their advice in 2008, CESR and ERGEG have already outlined their respective proposals<sup>3</sup>. Energy regulators are clearly in favour of establishing a regular transaction reporting scheme covering all wholesale transactions since market abuse can most likely not be detected with a case-by-case investigation approach. Thus, an appropriate and efficient trade data reporting needs to be foreseen in order to achieve the needed overview taking into account the increasing market integration across regions and the entire EU. Effective coordination between financial and energy regulators at national and EU-level, adequate access to relevant data by energy and financial regulators and effective coordination on cross-border issues by relevant EU bodies such as the Agency for the Cooperation of Energy Regulators (ACER) and the European Securities and Markets Authority (ESMA) should be ensured<sup>4</sup>.

Additionally, energy regulators would like to point out that transparency of price sensitive information (so called fundamental data) is also a very important and effective measure to avoid market abuse in energy markets. This is in particular true for the electricity markets where storability is almost not possible and therefore production and consumption have to match constantly. The publication of all relevant fundamental data before trading takes place (such as load, outages, foreseen amount of electricity from renewable sources, cross-border congestions, etc.) gives traders a good view of the current supply and demand situation. This can be seen as an important measure for the reduction of systemic risks, since with a better knowledge of the current market situation traders may refrain from building up dangerous positions and exaggerated risk taking.

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<sup>3</sup> Record-keeping, transparency and exchange of information. CESR and ERGEG advice to the European Commission in the context of the Third Energy Package, Ref. C08-FIS-07-03, December 2008, [http://www.energy-regulators.eu/portal/page/portal/EER\\_HOME/EER\\_PUBLICATIONS/CEER\\_ERGEG\\_PAPERS/Cross-Sectoral/2008/C08-FIS-07-03\\_Recordkeeping\\_2008-12-17.pdf](http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Cross-Sectoral/2008/C08-FIS-07-03_Recordkeeping_2008-12-17.pdf)

<sup>4</sup> For more details see the ERGEG response to the European Commission's public consultation on the "Initiative for the integrity of traded energy markets", Ref. C10-GA-62-04, July 2010, [http://www.energy-regulators.eu/portal/page/portal/EER\\_HOME/EER\\_PUBLICATIONS/CEER\\_ERGEG\\_PAPERS/Cross-Sectoral/2010/C10-GA-62-04\\_EC%20Market%20Integrity%20PC\\_21-Jul-2010.pdf](http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Cross-Sectoral/2010/C10-GA-62-04_EC%20Market%20Integrity%20PC_21-Jul-2010.pdf)

In summary, energy regulators support the idea of a sector-specific tailor-made market abuse regime for energy wholesale markets. Since it would be very difficult to address within the (revised) MAD **all issues** relevant for ensuring market integrity in energy trading (e.g. physical trading), ERGEG favours sector-specific measures to ensure transparency and integrity of wholesale markets in electricity and gas. Within such a regime for energy wholesale trading market misconduct in energy markets should be defined and the supervision competencies of energy and financial regulators and the future role of ACER (Agency for Cooperation of Energy Regulators, recently established and starting to become operational) and the forthcoming ESMA (European Securities and Markets Authority) should be clarified.