

IFIEC's response to the consultation paper draft by CESR and ERGEG on October 2008 on the electricity and gas markets

CESR and ERGEG advice to the European Commission in the context of the Third Energy Package

*Draft response to
Questions D.4 to D.6 - record keeping
Questions E.11, E.18 and E.19 - transparency
Questions D.7 to D.10 - exchange of information*

FOREWORD

Following the mandate of the Commission, CESR and ERGEG have focused on electricity and gas markets. Within this they also ask views of market participants on the fact that there are substantial interdependencies between electricity and gas markets and some other markets, such as emission allowances markets and other energy markets (e.g. coal and oil markets). In this respect IFIEC:

- expresses its worries concerning the emission allowances markets, as CO₂ emission cost (or opportunity cost) is influencing power price formation by more than 10 €/MWh at wholesale level. It's true that coal and oil price affect power prices in a higher proportion, but those are global markets with a significant number of players. As such it is more difficult for them to be influenced by a single party. By comparison, power generators are very large players in CO₂ markets, which are very illiquid and not under the same degree of regulator control as other markets;
- urges the authorities to develop the appropriate legislation to guarantee that CO₂ markets are also under the supervision of energy and securities regulators. Identical provisions being developed for wholesale electricity and gas markets should apply also for emission allowances markets.

SECTION 1: Record Keeping

1. Do you agree with the above mentioned analysis of the purpose of record-keeping obligations for supply undertakings in the Third Energy Package? If not please explain your reasons.
 - IFIEC fully agrees with the proposed purpose of record-keeping obligations in the Third Energy Package. However we have some remarks concerning the entities and transactions in the scope:
 - Firms which trade exclusively in cash-settled financial instruments related to electricity and/or gas should not be excluded as supply undertakings in the Third Energy Package. As they are part of the market, information about transactions undertaken by those firms should also be available to any competent authority on the basis of record-keeping obligations.
 - Investment firms acting in the markets must not be exempted from record keeping obligations.

- Contracts entered into with TSOs to balance supplies are specifically excluded. This will limit the capability of regulators to analyse potential market abuse in the balancing markets, which in most member states are oligopolistic if not monopolistic.
 - Excluding cash-settled derivatives could increase the opacity of markets and invite some market players willing to circumvent record keeping obligations to develop instruments based on cash-settled derivatives instead of more controlled physical products.
 - The contracts with regard to the direct supply of end-consumers should be outside the scope of record-keeping, because they are considered to be retail market deals. Such contracts comprise bilateral deals between supply companies and any kind of end consumer – private, commercial or industrial – for deliveries of electricity or gas to cover their individual demand. This is e.g. also related to supply contracts between industrial end users delivering energy to their own affiliates. The details of the latter contracts are purely internal to the respective corporation, do not affect the wholesale market and constitute sensitive information. So it has to be made sure that retail contracts between industrial end-users do not fall under the record keeping and publication requirements.
2. Taking into account the potential purposes of record-keeping requirements under the Third Energy Package, do you agree with the above mentioned minimum contents for records to be kept by supply undertaking?
- IFIEC proposes adding financial margining conditions as another feature in the minimum content of a transaction. This would meet concern that through a differentiation of margining obligation, large suppliers may introduce discrimination among wholesale customers and benefit their supply affiliates against third parties.
3. If not, please specify the items not necessary or additional items necessary with respective reasons.
- Concerning the above mentioned problem, ERGEG and CESR could agree in a simple form to typify the margining agreement linked to a transaction, using indicators such as: % of guarantees related to contract value, mark to market or kind of guarantees accepted (cash, corporate, ...).
4. Do you see practical difficulties if investment firms not covered by the scope of the Third Energy Package are not obliged to keep the additional contents of transactions in financial instruments in their records?
- Investment firms operating in the gas and electricity markets should be submitted to the same obligations as any other wholesale partner. Otherwise an incentive to create special firms will appear.
5. Which option do you think is most efficient for the purposes of the Third Energy Package?
- Records have to be kept electronically to be workable. We fully support the preference expressed by CESR and ERGEG for an electronic format of the records.
6. If an electronic format will be required, is it sufficient to leave the design of the specific kind of “database” used to retain the minimum content of the records to each supply undertaking?
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7. If possible, please provide indications of the specific costs involved with different electronic formats conceivable (e.g. from Excel sheet to more sophisticated software).
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SECTION 2: Transparency

8. Do you see a need for a harmonized publication of aggregate market data on an EU/EEA level? Please provide your arguments for / against such publication.
 - Yes. It's consequent with building up the internal energy market. IFIEC also judges as positive a mandatory character for dissemination.
9. Do you consider that this publication should cover all instruments, including those covered by MiFID?
 - Publication should cover every instrument used by energy traders. Financial instruments can not be excluded from the scope. The benefits of transparency exceed any additional cost for facilitating access to information on transactions in derivatives.
 - Transactions with TSO related with balancing mechanisms or balancing markets should also be submitted to publication obligations.
10. Among the information proposed to be published, which ones are the most useful and why? Which one(s) should be published?
 - Volume traded, prices indices and market structure are all useful. Regarding market indicators, a detailed market share of participants cumulating a significant amount of trade (i.e. 80%), not necessarily anonymous, is preferred. As it's stated by the EC in the Sector Inquiry report, benefits of more transparency will outweigh the risk of collusion.
11. Are the two levels of aggregation on products proposed appropriate and useful?
 - Both proposed levels of aggregation on products are adequate.
12. Among the options proposed for the level of aggregation during the period covered, which ones are most useful and why? Which one should be chosen?
 - A daily level of aggregation is a good compromise for market players.
 - To keep administrative burdens low, it could be a reasonable approach to start with publishing a simplified number of products (i.e. only base-load profile) and maturities (i.e. first 3 quarters ahead and next 2 years ahead)
13. Among the options proposed for the frequency of publication, which ones are the most useful and why? Which one should be chosen?
 - It's desirable to assure a daily publication, with the shortest delay possible; for transparency purposes information should be always making the news. Getting information two months after would only cover the need of academics.
14. Do you consider that, in practice, as far as transactions in energy related products are concerned, distortion of competition may result from unequal access to or lack of transaction information? Please provide evidence for your agreement or disagreement.
 - Yes., as unequal access distorts competition. A clear example of this is trading between affiliates of a vertically integrated utility. Another example is cross trading among linked markets like power and emission allowances. Integrated trading firms share information and may anticipate to other players in the market (i.e. plant trip, bias in demand or renewable injection, expected congestion problems, or selling of CO2 permits, or a purchase of a forward maturity, ...).
15. Do you agree with the results of the fact finding exercises and their analysis for the electricity and gas markets as described above? If not, please provide reasons for your disagreement.
 - Basically, we agree with your findings., with two remarks:

- The statement that “energy derivatives use predominately physical delivery rather than cash settlement” may not be extended to all markets. Cash settlement is very popular where a liquid spot market exists.
 - Current OTC markets are opaque. But probably opacity is inherent to these markets and their methods of negotiations.
- Unfortunately the crossed effect of electricity and emission allowance markets has not been discussed under question E.19.

16. Is there any part of the electricity and gas markets (either spot or energy derivatives trading) where there is lack of pre- and post-trade information which affects the efficiency of those markets or a part of them? In any case, please provide examples and your reasoning.

- Bilateral trade among affiliates of vertically integrated companies is opaque to the market. Asymmetric information compared to other market participants is evident.
- The best pre-trade information is a continuous and sound publication of system fundamentals, while post-trade information remains essential for market players to develop their commercial strategies.
- We do not share the view that transparency may reduce liquidity. Motivation for trade will remain even if margins become narrower because of a higher transparency.

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18. Do you favour the status quo? Please provide reasons for your opinion?

- No, as transparency cannot be left to self regulation. Transparency should be designed to mitigate structural market imperfections.

19. Do you favour a key principles approach? If so, what characteristics should it have?

- It seems reasonable to focus in post-trade transparency rather than pre-trade. (As mentioned above, pre-trade may be substituted by an intense publication of fundamentals).
- However delaying publication is not a good approach. Markets are vivid and require a close feed-back. It's better losing some detail by aggregation than having delayed, but more complete information. To reduce administrative burden, a step-wise approach could be taken where at the beginning, the firms deliver a reduced set of data to the regulators. This process and its effects on the market should be closely monitored by the regulators, so that any addition could be decided step by step.
- A differentiation of requirements between organised markets and OTC is not desirable. Both trades should be submitted to the same obligations; otherwise an incentive to escape from public scrutiny will appear.

20. Do you favour a more comprehensive regime/initiative? If so, what would be its characteristics?

- Yes, if it solves the problems indicated in question 19.

21. Do you agree with the preliminary analysis included in paragraphs (a) to (e)?

- IFIEC agrees with the preliminary analysis. However, the principle mentioned by the Commission in the Sector Inquiry must not be overlooked: the need for transparency outweighs the fear of collusion. The report should not be taking the responses given in the Call for Evidence as full representative of the situation, but as representing the opinion of the group of responders (that probably is biased with large incumbents).
- In (d) IFIEC does not share the view of risk of a loss of liquidity due to transparency regulations.
- In (e) IFIEC would like to repeat the disadvantages of delaying publication mentioned above.

22. What other views do you have on the matters covered in this section on trade transparency?

- See question 21 above.

SECTION 3 : Exchange of Information

23. Do you agree with the exchange of information between securities and energy regulators only on a case-by-case basis instead of a periodical and automatic exchange of information?

- IFIEC members are not familiar enough with TREM system to provide an opinion. We feel that automated information exchange may contribute positively to a better market regulation and discourage participants of bad practices, but have no basis to confirm this. Once an information exchange system is in place, the periodicity should not be a limiting factor. Recent experiences in financial markets highlight the benefit of preventing actions to avoid market failures.

24. Do you agree with the proposal of the establishment of multilateral and bilateral agreements between energy and securities regulators for exchanging information on cross-border and local basis respectively?

- IFIEC agrees. The emission allowances market should also be included on the list of commodities to be commonly supervised.

25. Which securities regulator would you prefer to be responsible for providing the information required by the energy regulators regarding the transactions of a branch of an investment firm: the host Member State securities regulator of the branch or the home Member State securities regulator of the investment firm?

- As national energy regulators will work closely with their corresponding national securities commission, it seems more appropriate to solve it locally, through the securities regulator hosting the branch. Alternatively, as securities regulators are keeping links with each other, any requirement outside the member state could be easily channelled into working that way.

November 2008