New Energy Regulation in Europe

REMIT:
Started with a bang!

Ended with a whimper?

Johannes Kindler
Vice-Chairman Federal Network Agency, CEER Vice-President

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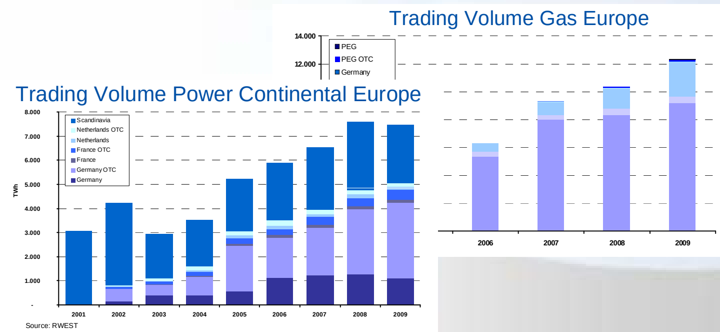
Trading plays crucial role

Energy Trading in Europe is a fast expanding market



- **Crucial** to reach the **EU internal market**
- **Significant** for the integration of **Renewable Energy** (EU)
- **Important tool** for suppliers and big consumers **to control and hedge risks**

The risks of trading

- Trading is important, but bears also **considerable potential for misbehaviour** (e.g. market abuse and insider trading) !
- Thus, the **European Commission** tabled a proposal for a **Regulation on Energy Market Integrity and Transparency** (REMIT)

→ Proposal picks up the **recommendations of European Energy and Financial Regulators**!

The risks of trading

- **Trading** is not only physical trading but also **driven by financial markets**
- Realistic view needs to acknowledge the imbalance in „power" between investment banks and physical traders, esp. medium sized or smaller utilities
- Investment banks can profit from worldwide hedging systems

REMIT – impact and practical application

Main issues in REMIT:

- REMIT prohibits
  - **insider trading** (Art. 3 REMIT) and
  - **market manipulation,** incl. attempts (Art. 4 REMIT) on wholesale energy markets
- This prohibition does **not apply to wholesale energy products that are financial instruments** and fall under the Market Abuse Directive (MAD)
- **Publication of insider information** is required!

Transparency

- **Strategic foundation** of REMIT is **transparency of fundamentals**.
- Data needs to be published by the market-participants in time.
- This complex has been regulated separately.

REMIT: The rules

REMIT prohibits the utilisation of insider information before disclosure to the market

But one important exemption:

- Transactions to cover the immediate physical loss resulting from unplanned outages, where not to do so would result in the market participant not being able to meet existing contractual obligations
- Exemption was tabled in very late stage!
- Successful lobbying of oil and gas producing companies!

→ **Will this exemption erode the REMIT rules?**

REMIT: The tools

Only registration of traders (Art. 7a), no authorisation

- Prior to trading market participants shall register with the national regulatory authority, but only with one
- National regulatory authorities set up national registers
- Agency sets up European register

→**Contrary to US-practice:**
Stricter rules for licensing in the US!

→**But: Discussion** about authorisation/licensing procedure is **only postponed!**

REMIT: The tools

Reporting obligations

- Reporting of the necessary information by market participants (or third parties on their behalf)

- Reporting obligation starts **earliest in 18 months**!

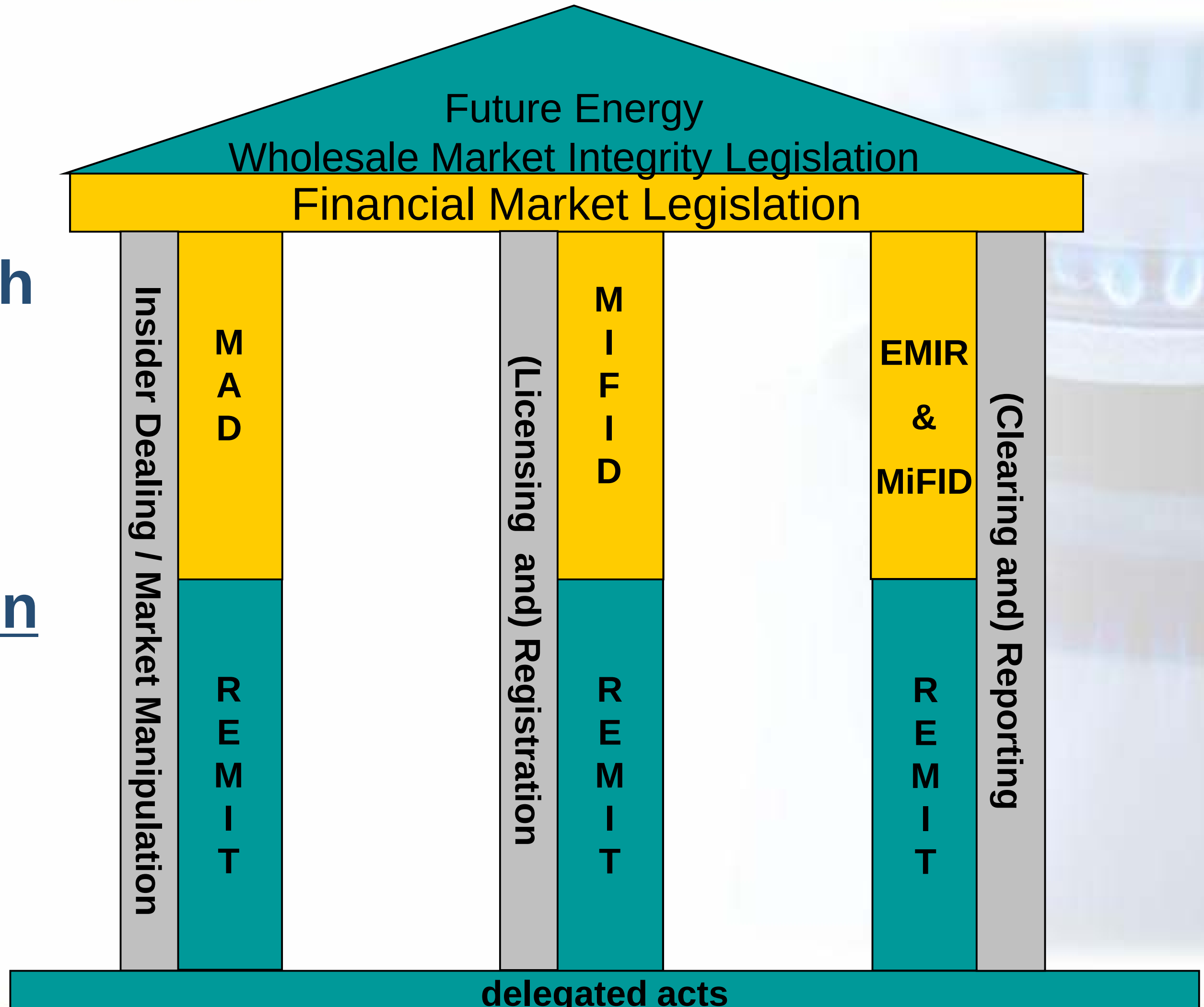
- **No double reporting**:

  Transactions reported in accordance with financial legislation (MiFID or EMIR) do not have to be reported again

REMIT – impact and practical application

REMIT picks up energy regulators' <u>general</u> approach

But <u>interrelation with financial market regulation</u> is crucial!
Risk of dangerous shortcomings!



REMIT and financial Legislation

Relevant/Upcoming Financial Legislation

- **MiFID =**
  Markets in Financial Instruments Directive
  → Investors Protection
- **EMIR =**
  Regulation on OTC derivatives, central counterparties and trade repositories
  → Risk Mitigation
- **MAD =**
  Market Abuse Directive
  → Market Integrity,
  supposed to become a Regulation
  (directly applicable in all Member States)

REMIT and financial legislation

Review of the Markets in Financial Instruments Directive – MiFID

- **Current coverage:**
  - Products: Financial instruments
  - Investment firms – exemption for specialised commodity trading firms
- **Review:**
  - EC launched public consultation on a revision of MiFID in December 2010
  - Legislative proposal (so called MiFID II and MiFIR) currently discussed by European Commission

REMIT and financial legislation

- **Possible elements of the MiFID review**
  - Extension of the scope of MiFID to cover energy trading firms
  - Obligation for some (?) energy traders to obtain MiFID license

  → Obligation for some (?) energy traders to fulfill capital requirements of the Capital Requirements Directive (CRD)

- **Possible effects on energy market and traders**
  - Some (?) energy firms might decrease trading activities due to additional cost
  - Some (?) energy firms might decide not to hedge their underlying commercial risk – esp. smaller firms affected?

  → **This would increase overall risks!**

  → **This would negatively impact on the size of the market and liquidity/volatility and thus decrease of competition!**

REMIT and financial legislation

Regulation on OTC derivatives, central counterparties and trade repositories (EMIR)

- **Background**
  - In September 2010, the European Commission presented legislative proposal
  - European Parliament amendments July 2011
  - Regulation of OTC derivatives → reaction to financial crisis
  - Aim: improve transparency and safety of OTC derivatives / mitigate systemic credit risk
- **Topics**
  - Reporting obligation to trade repositories
  - Obligation to centrally clear all standardized OTC derivatives
  - Clearing thresholds for non-financial counterparties

REMIT and financial legislation

Regulation on OTC derivatives, central counterparties and trade repositories (EMIR)

- **Danger: Overregulation of market participants which do not create systemic risks**
  - Exemption from the CCP clearing requirement for non-financials:
    - as long as their positions do not exceed a pre-defined threshold
    - who use OTC derivatives for hedging risks arising from their core business activities
  - **Definition of threshold is crucial!**

→ ESMA (after consulting other authorities, e.g. ACER) will advise the Commission on the level of the thresholds

REMIT and financial Legislation

Review of the Market Abuse Directive – MAD

Current coverage:

- Prohibition of Insider Dealing and Market Manipulation for financial instruments admitted to trading on regulated markets

Review:

- EC launched public consultation on a revision of the MAD in June 2010
- Legislative proposal (Regulation!) currently discussed within European Commission
- **DG MARKT aims at extending the scope of MAD to financial instruments traded on all (!) trading venues, incl. brokers and to spot commodity contracts (which have an impact on the price of the financial instrument)**

→ This is crucial for the scope of REMIT!

Summary

- **Financial market regulation could heavily affect energy trading and energy traders!**
- **This might possibly lead to**
  - Different **reporting channels** for energy traders
  - **Clearing obligations** (if above threshold) for energy traders
  - Obligation for energy traders to obtain **MiFID license**
  - Obligation for energy traders to fulfill certain **capital requirements**

→Too burdensome requirements would have negative effects on market size, liquidity and competition!

Conclusion

- Possible risks by not coherent financial market regulation:
  - Relation between spot and derivatives could be diluted
  - REMIT – superfluous???
  - Role of energy regulators could be limited compared with financial regulators (Do they have resources to adequately tackle energy markets?)

Thank you for your attention!