European Energy Regulators' response to the European Commission's public consultation on "Initiative for the integrity of traded energy markets"
21 July 2010

1 General remarks

In December 2008 CESR and ERGEG recommended in their joint advice to the European Commission 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).

ERGEG welcomes and strongly supports the initiative of DG ENER to establish a consistent and effective market integrity framework and is pleased to submit the following response to the public consultation on the "Initiative for the integrity of traded energy markets". The supervisory capabilities should embrace all the electricity and gas transactions, independently of the nature of the product (financial and physical), the maturity (spot and forward), and the market (exchanges and OTC).

EU electricity and gas markets have developed over recent years and will continue to develop towards fully integrated EU markets. Complementary to market design a proper market integrity framework is an indispensible legal element for a well-functioning and mature market. Such a framework should accompany market development from the present national/regional level to the single internal European one. Accordingly, the surveillance scheme to be adopted should involve national authorities and EU authorities.

The solution to be adopted should define the role and responsibilities of the different actors involved, with special reference to the cooperation of national and EU energy regulatory authorities and national and EU financial authorities. Such an approach would represent an essential tool to support fair and enhanced competition and create trust in price formation and market results, to the ultimate benefit of end-consumers.

2 Detailed remarks

Question 1. Are there particular developments in relation to oversight of energy markets at a national, European or global level that we have not properly considered?
Regarding the markets for electricity and gas DG ENER´s considerations are complete and appropriate. However with regard to CO2 emissions in January 2010, the French Ministry for Economics and Industry mandated M. Prada, former president of "Authorité des Marchés Financiers" (AMF: the French Securities Authority), to establish a Commission whose objective was to define proposals needed for the regulation of CO2 markets.

We therefore acknowledge the main conclusions of the Prada Commission (April 2010), in considering that the surveillance of the CO2 market should be based on three essential elements: first, financial regulators should be entrusted with the CO2 market surveillance, and, simultaneously, the missions of energy regulators should be enlarged to include the monitoring of the fundamentals of carbon markets. Second, the cooperation of national financial regulators and energy regulators should be organised. Finally, the European Securities and Markets Authority (ESMA) should be entrusted with the supervision of the entire system, in cooperation with the Agency for the Cooperation of Energy Regulators (ACER).

Question 2. Do you agree that the current Regulatory Framework should be updated to include clear rules governing energy market oversight? Please justify your reply.
Under the mandate given by the European Commission in October 2008, ERGEG elaborated, together with CESR, proposals for a sector specific market abuse regime (E08-FIS- 07-04[1]) in the context of the Third Energy Package.

[1] CESR and ERGEG advice to the European Commission in the context of the Third Energy Package – Market Abuse, Ref. E08-FIS-07-04, October 2008, http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_CONSULT/CLOSED%20PUBLIC%20CONSULTATIONS/CROSS_SECTORAL/Financial%20Services/Market%20abuse%20framework/CD/E08-FIS-07-04_%20MAD%20Advice.pdf

The CESR/ERGEG advice stated that “Directive 2003/6/EC (“Market Abuse Directive” - MAD) provides a common EU framework for the disclosure of information to the market and aims at the prevention, detection, investigation and sanctioning of insider trading and market manipulation in financial markets. MAD only partly covers energy markets as it is designed for the financial markets. It 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 markets products are covered only if they are admitted to trading on a regulated market”.

Thus, the scope of MAD may not properly address market integrity issues in the electricity and gas markets.

The scope of market abuse regulations (insider trading, market manipulation) does not apply to physical markets for electricity and gas. Thus, activities in these markets are not covered as long as the derivatives market is not affected. In addition, the commodity derivative specific definition of insider information in MAD is difficult for securities regulators to apply, as there is no clear definition of the information that users of commodity markets can expect to receive in accordance with accepted market practices in those markets.

In the case of energy markets, this information is related in particular to physical data (generation and plant availability, network operation, maintenance, etc.) and in addition market misconduct may be related to physical fundamentals (generation withholding in the case of electricity for instance).

ERGEG still maintains this view and advocates that the legal framework regarding market abuse in energy markets should be enhanced. As players become active in different markets and trade different products, this will exacerbate the gaps noted above. In addition, formal cross-border cooperation to carry out market oversight is lacking. There is also no consistent oversight of CO2 certificates markets and competences of national regulators in terms of enforcement are not consistent across the Member States.

It is important that rules are clear and enforceable and do not leave gaps. For example, in current MAD the definition of inside information is unclear and the obligation for "issuers" to publish inside information is inappropriate for energy trading as there is no real issuer of the product.

There are already some market monitoring schemes at national or regional level (e.g. Nordic market, France). These can be used as examples for elaboration at European level.

Question 3. Do you agree that this update should ensure integrated/coordinated oversight between financial and commodity markets and across borders?

Experience (e.g. in the US market) shows that market abuse can affect both exchange and OTC trading, physical and financial products, and can sometimes extend across several countries. Therefore, evidence suggests that the oversight regime should ensure proper oversight of all physical and financial trades and their interaction, and take into account the specificities of energy markets. It should also ensure 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 ACER and ESMA.

Question 4. Do you agree that the overlap of physical and financial (derivative) markets and the cross-border nature of the market currently leads to sub-optimal oversight of energy markets?

Yes, we agree, since there are some gaps in the oversight of the market between physical and financial (derivative) markets and regarding cross-border trading that may result in non-competitive wholesale prices, which are an important reference for end-user consumer prices. Therefore we are supporting the development of legislation addressing these gaps in an effective manner. Cooperation between the different entities involved should be formally defined and enhanced.

Question 5. Do you agree that definitions of market misconduct for gas and electricity markets should be consistent across EU? If not, why not?

ERGEG agrees that the definitions of market misconduct should be consistent in order to contribute to an efficient single market. As regional markets get more integrated by market coupling, the importance of having the same rules increases. Thus, definitions should only differ if specific peculiar market characteristics (i.e. insular systems) make it really necessary.

The definitions of misconduct should be as clear as possible not leaving room for different interpretations. Otherwise surveillance and enforcement on a cross-border level may become difficult. The definitions should not be too restrictive in terms of scope, should allow flexibility to accommodate unforeseen circumstances but, at the same time, should not merely reflect or be limited to the lowest common denominator.

Question 6. Do you agree that market misconduct should follow the MAD definitions? If not, why not?

No – the MAD provisions are essential but not sufficient to regulate market misconduct in the energy markets which require more precise definition regarding misconduct.

Further provisions specific to energy markets should be added to regulate, for example: capacity withholding, overbooking, the use of derivatives / financial markets to hedge positions in the physical power market, capacity withdrawals (utilisation of plants), inside information and insider trading (e.g. generation outages). It will be necessary to define what information market participants can expect in accordance with accepted market practices. There should also be a link to the comitology guidelines which will lead to an improvement of the transparency in electricity and gas markets.

Question 7. Do you agree that specific account of the specificities of the physical energy markets should be taken of energy markets through guidance rather than in legislation? If not, why not?

Whereas we do not take a final view on the proper legal instruments, some requirements need to be fulfilled, these are:

- Harmonised rules for definition of market misconduct;

- Data access for oversight purposes;
- Enforcement in case of misconduct.

All related provisions need to be properly clear and uniform without leaving room for interpretations. Possibly non-binding documents may allow for regulatory arbitrage.

Thus, ERGEG finds that in general requirements regarding also the physical energy markets should be included in legislation rather than through "guidance".

Question 8. Do you agree that regular market monitoring is an essential function to detect market misconduct?

ERGEG agrees that effective and regular market monitoring is important to detect market misconduct. Due to a lack of consistent surveillance and data access a full market assessment is currently impossible.

We assume that in many cases, market misconduct would not result in huge impacts on market prices (e.g. price spikes), but rather in smaller deviations from a "fair and orderly" price. However, the impact of this behaviour on the well-functioning and trust in the markets should not be underestimated. Such misconduct may be difficult or impossible to detect through irregular monitoring. Moreover, the monitoring entity and the personnel performing the monitoring activities need to have a thorough understanding of the respective markets. The required knowledge can only be obtained and maintained if the responsible body is regularly monitoring market developments. It should be noted that this knowledge is currently often also available at the surveillance entities of market places (e.g. Power Exchanges).

Finally, the impact of the simple existence of continuous and consistent market surveillance should not be neglected. The fact that currently no consistent monitoring is in place may allow types of behaviour to occur which would not be pursued in a situation where a clear definition on misconduct exists and a regular monitoring is in place.

Question 9. If yes, given the characteristics of wholesale energy markets, do you agree that market monitoring is best organised on EU level?

From ERGEG's perspective market monitoring includes systematic data reporting together with analysis of the behaviour of market parties and the level of competition.

The fact that EU energy markets are becoming increasingly integrated at regional and EU-level suggests that market monitoring structures should take account of this development. In this light, an appropriate and effective implementation of an EU level coordination of the monitoring of energy wholesale markets and of financial products may be appropriate. Pure wholesale trade monitoring should be coordinated at EU-level in close cooperation with national entities, in order to use efficiently existing expertise on national specificities such as different generation mixes.

However, analysis at national level would remain an essential competence of national regulators and a regional or national approach may be effective for less integrated markets such as balancing markets.

All regulatory entities involved in monitoring should be entitled to firmly request the opening of an investigation (to be run by the relevant monitoring entities) in case misconduct is suspected. Moreover all relevant authorities should also be involved in the course of the procedures (e.g. have the right to provide opinions formally).

Question 10. If yes, do you believe that ACER should be given the role of an EU level monitoring body for wholesale energy markets?

The issue of responsibility is a political issue. Thus, it has to be discussed between Member States, European Commission and European Parliament. In any case, the Almunia proposals and the revised financial regulation have to be taken into account.

However, given the envisaged regulatory structure under the 3rd Package it seems natural that ACER plays a vital role in coordinating monitoring activities (see ACER monitoring tasks, Article 11 of Regulation 713/2009). For example, ACER could be responsible for data collection across the EU. Moreover, ACER should perform "central monitoring tasks" (still to be defined in more detail) and coordinate closely with national energy regulators and also with financial regulators. Cooperation with ESMA on financial trades would also be

necessary.

Clearly at present, ACER does not have the legal powers, budgetary means and human resources to perform such a task and thus it is expected that this would also be taken into account and adjusted appropriately by DG ENER when legislation is adopted.
As ACER is just being created and has a very challenging task in the coming years, any extension of its remit should not jeopardise its ability to undertake its current functions. Even with additional resources, ACER will inevitably not be as close to national markets and will not have as detailed an understanding of physical characteristics as national regulators. The close involvement and effective cooperation of national authorities has to be ensured in the interim phase of development of the European legislation. As market integration evolves, such as via day-ahead market coupling (as it is already in place between France, Belgium and The Netherlands, between the Nordic market and Germany or between Spain and Portugal), a cross-border dimension is required within the oversight regime. This requirement will become more important the more markets are going to be integrated. Given the over-riding importance of the interactions between physical and financial markets but also across borders due to further market integration, this means that an effective monitoring regime is likely to require responsibilities at a national level with a close EU coordination.

Question 11. Do you agree that the EU level monitoring body for energy markets should have a coordinating role to ensure effective application of EU level rules for energy markets? If not, why not?
See answer to Question 10.

Question 12. In your view, would enforcement of market misconduct rules be best organised on national level or EU level?
ERGEG considers that enforcement should remain a national responsibility. However some coordination at EU-level may be needed in case misconduct affects several markets and jurisdictions. Some aspects, such as the level of penalties, should also be coordinated.

a. If on national level, would national energy regulators or national financial regulators be better placed to enforce compliance?

Whether energy or financial authorities are best placed to carry out enforcement will depend on the proposed legal definition of market misconduct. In any case, energy regulators should be tasked to enforce compliance for issues falling under energy legislation. Coordination between different entities may be needed when competencies overlap, however ERGEG considers overlaps less problematic than existing gaps.

b. If on European level, which institution would be best placed to enforce compliance?

Question 13. Do you agree that the market monitoring body for energy markets should also be able to monitor EUA transaction?

The EUA market is closely related to energy markets. Participants in the EUA market are often also involved in energy markets, as EUA are mainly allocated to energy operators and the energy sector must return the largest share of EUA to Member States every year. As a consequence, the EUA market is able to influence outcomes and prices in the energy markets.

We therefore consider that bodies which are in charge of monitoring energy markets should consider EUA transactions as well, both in regulated and over-the-counter marketplaces.

Moreover, monitoring entities should also examine transactions regarding other credits accepted in the Emissions Trading Scheme, such as Certified Emission Reductions (CER) and Emission Reduction Units (ERU).

Question 14. Would monitoring of traded carbon markets be best organised on national or on EU level?

From a geographical standpoint, the EUA market is basically European. However, Member States play a key role in the Emissions Trading Scheme, since they are responsible for issuing allowances, allocating them among installations covered by the Scheme and cancelling EUA returned by operators.

Therefore monitoring of carbon markets could be carried out at the European level, however the European monitoring body should implement this activity in cooperation with relevant national authorities.

Question 15. If on EU level, do you believe that ACER could be an appropriate monitoring body?

If monitoring of carbon markets were to be implemented at European level, then in principle ACER could be responsible, in possible cooperation with ESMA. It should be noted that at present monitoring of carbon markets is not listed in the ACER Regulation as a core ACER competence. Likewise, monitoring of carbon markets does not fall within the remit of most national energy regulators. The competency to regulate carbon markets may depend on how EU Allowances are classified (e.g. as a financial instrument, a commodity or a new instrument as proposed by the Prada report). In this light, it is possible that another ad hoc European body, dedicated to EUA monitoring, would be better placed to monitor carbon markets. Cooperation with ACER and ESMA should be envisaged where necessary in order to guarantee integrated oversight of energy markets.

Question 16. Do you agree that it is not appropriate, at least at present, to consider coal, oil and other commodities along with wholesale gas and electricity markets? If not, why not?

For the time being, commodities other than electricity and gas markets, such as oil and coal, can hardly be included within the scope of the measures aimed at ensuring transparency and integrity of wholesale markets. The global dimension of oil and coal markets, in fact, makes it difficult to oversee them effectively.

Nevertheless, it is important to ensure that relevant information on these markets is properly disclosed. The market dynamics of these commodities significantly influence both electricity and gas markets, so it is important that those responsible for the integrity of electricity and gas markets can access information on coal and oil transactions.

Question 17. Do you agree that it is appropriate to apply exemptions and de minimis levels? If not, why not?

Oversight regimes do typically put some burden on market participants and this is also the case in electricity and gas markets. The design of this regime needs to take into account that small operators cannot bear the same obligations imposed on other players. In principle, therefore, it could be reasonable to provide exemption and de minimis clauses, but some risks have to be carefully considered.

However, recent experience (i.e. the VAT fraud on spot carbon markets) shows that small undertakings could pose a serious risk to markets. In addition, any exemption or de minimis clauses should not provide incentives to undertakings to split into smaller entities to avoid being caught by the legislation. Consequently, small operators should not be exempted from provisions aimed at detecting market abuse, or from record-keeping and reporting obligations, but could meet them in a less onerous way, for instance, benefitting from a reduction in reporting frequency and a simplification of data reporting. The main advantage of this approach would consist in guaranteeing that all transactions are eventually reported. An adequate definition of “small company” and design of their reporting requirements will be required in order to avoid that the behaviour of small companies may go undetected.

Question 18. Do you agree that market data relating to energy market transactions should be reported centrally? If not, why not?

Yes, ERGEG agrees.

Transaction reporting enables the relevant authorities to oversee the market and detect market abuse in the most efficient way; therefore ERGEG is in favour of an efficient transaction reporting regime as a necessary element for effective supervision. Also reporting requirements should reflect the development of the different markets moving from a national dimension to a pan-European one.

The European dimension of the markets will require a centralised reporting solution. Such a solution would mitigate the regulatory burden put on market participants active in several markets; otherwise they would have to face a transaction reporting obligation in each Members State.

There is also agreement that a centralised solution can mitigate the regulatory burden put on small companies, as the market place (e.g. the broker or the energy exchange) could report centrally the transaction on behalf of the market participants.

A centralised transaction reporting solution allows an access to information for all identified monitoring entities, including national regulators.

ERGEG is aware that confidentiality of the information has to be ensured during the entire process of transmission and further utilisation of the confidential data. The authorities requesting information should therefore be required to provide adequate methods and arrangements to secure this.

It should be noted that the European Commission's EMIR proposal may require setting up trade repositories at European level. In this event, it should be ensured that no duplication occurs, i.e. data required for transaction reporting should be the same data required for trade repositories.
Last but not least, the implementation of a centralised reporting solution should not prevent NRAs from requesting market participants to provide additional data over and above the information reported to a central facility, in case of monitoring needs.

Question 19. Do you agree the body with an oversight role requires full access to fundamental data relating to carbon?

Given the existing links between energy markets and CO2 markets, it seems to be relevant both for EUA monitoring and for electricity and gas monitoring, that the responsible body has access to fundamental data relating to carbon.