International Swaps and Derivatives Association, Inc.
One Bishops Square
London E1 6AO
Tel: 44 (0) 20 3088 3550
Fax: 44 (0) 20 3088 3555
Email: isdaeurope@isda.org
Website: www.isda.org

**2nd Floor**
**36-38 Botolph Lane**
**London EC3R 8DE**
**Tel +44 020 7929 0081**
**Fax +44 020 7621 0223**

European Federation of Energy Traders
Amstelveenseweg 998
1081 JS Amsterdam
Tel: +31 (0)20 5207970
Email: secretariat@efet.org

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**CESR-ERGEG Call for Evidence on Record-Keeping and Transparency in Supply Contracts and Derivatives for Electricity and Gas**

**ISDA-FOA-EFET Response**

ISDA, the FOA and EFET welcome the opportunity to respond to the CESR-ERGEG Call for Evidence on Record-Keeping and Transparency in Supply Contracts for Electricity and Gas.

These organizations have been cooperating as parts of the Commodity Derivatives Working Group (CDWG) and Commodity Firms Regulatory Capital Working Group (CFRC WG), to engage in the EU review of commodities regulation as mandated under MIFID and the CRD. The members of these working groups are mainly risk officers, compliance officers, and lawyers **from major commodity firms** active in the EU.

These organizations were also very involved in discussions around transparency requirements for wholesale electricity and gas markets prior to the adoption of the 3rd Energy Package in September 2007, which led to this Call for Advice from the European Commission to CESR and ERGEG.

*Where we use the term 'CDWG' in this submission, we are referring to the view jointly held by each of these associations regarding the principles of financial regulation of commodity firms and specifically, in this context, in relation to the questions put by CESR and ERGEG in this Call for Evidence.*

ISDA represents participants in the privately negotiated derivatives industry and today has over 800 member institutions from 56 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities.

The FOA is the industry association for 160 international firms and institutions which engage in the carrying on of derivatives business, particularly in relation to exchange-traded transactions,

and whose membership includes banks, brokerage houses and other financial institutions, commodity trade houses, and energy companies, exchanges and clearing houses, as well as a number of firms and organisations supplying services into the futures and options sector.

EFET is an organisation designed to improve the conditions of energy trading in Europe and works to promote the development of a sustainable and liquid European wholesale market. EFET is complementary to existing industry organisations in Europe as it is solely dedicated to energy trading issues, and lists over 50 firms as members.

**Executive Summary**

The CDWG welcomes the opportunity to provide its views to CESR and ERGEG as they formulate their advice to the European Commission on record-keeping, fact-finding, transparency and market abuse in electricity and gas wholesale markets.

The CDWG would like to express its support for:

- **A record-keeping obligation for all market participants active in wholesale trading of supply contracts and derivatives in electricity and gas.** It is important that this obligation is appropriate for the market and not overly burdensome. Moreover, it should not have the effect of duplicating existing requirements and practices. Naturally, MIFID-regulated firms should not be required to duplicate existing MIFID requirements for record-keeping. We strongly oppose the imposition of a rigid format for this record-keeping – rather, we believe that these records should simply be kept in a format that will e.g. ensure accurate and helpful information for regulators when these records are requested (i.e. the requirements in this context should be principles-based, and in keeping with existing record-keeping practices of market participants). We support provision of these records to regulators ***on request***, where wrong-doing is suspected.
- **Publication of data on use of essential infrastructure** e.g. information about electricity transmission and generation, gas transportation and gas storage - allowing new market entrants to benefit in practice from third party access to this infrastructure. We believe such information would benefit price formation in these markets, namely wholesale electricity and gas markets.

The CDWG opposes adoption of any other new transparency requirement on participants in wholesale electricity and gas markets, in relation to any of the instruments mentioned in this paper, for the following reasons:

- There is **no evidence of any market failure** concerning transparency in these markets. We note that the references to a 'lack of transparency' in the DG COMP Energy Sector Inquiry, for example, refer more to a lack of transparency in use of essential infrastructure (as mentioned above) rather than to any clear evidence of sub-optimal transparency in e.g. electricity and gas derivatives markets. Recent exploration by the European Commission of the case for pre- and post-trade transparency in all bond and derivatives markets is moving towards conclusions that include that there is no such case for transparency requirements in (inter alia) commodity derivatives markets.
- **Much of the data that regulators might be considering for coverage through transparency rules is already available to the market**, either via commercial market data service providers (such as Platts and Bloomberg) or via exchanges and brokers;
- We believe in the concept of 'optimal transparency': i.e. that **transparency is not an end in itself, but rather a means towards market efficiency.** 'Optimal' transparency encourages participation in wholesale markets (in general) by customers and liquidity providers. Overly stringent disclosure requirements could cause more volatility in the

physical commodities and derivatives markets as participants exploit (or are affected by) disclosures on market positions (damaging the interests of those seeking to hedge commercial risk, in particular), ultimately damaging liquidity.

- **A key rationale often given for imposition of transparency requirements in markets is protection of the interests of retail investors**, who may not have the same access to information as enjoyed by wholesale participants. Given that retail participation is not a significant factor in these markets (and that where it is a factor, it is intermediated by professional investors), we do not believe this rationale is pertinent in this case;
- We are concerned about the **cost-benefit** ratio associated with any new transparency or transaction reporting requirement, particularly when many of the instruments that could be covered by such a requirement are non-standardised, customised and complex;
- Further to the above, it is unclear to us what, if any, practical use regulators will necessarily be able to make of data gathered through any ongoing transparency requirement, because of the **non-standardised and complex nature of many of these instruments**. If regulators attempt to simplify methods of provision of such data through reporting formats, this will necessitate high levels of investment in IT systems by affected firms.
- **We are concerned that imposition of new transparency requirements will broaden the scope of the Market Abuse Directive** in a way that has not necessarily been considered by regulators, particularly as regards broadening the range of information requiring disclosure under this Directive, and preventing persons within in-scope firms who have access to this information from trading on related instruments, even when they have otherwise legitimate reasons for doing so;
- **There seems to be some kind of assumption built into the questions put by the Commission (and by CESR and ERGEG to industry) that aggregate market data would be made available to regulators by market participants. We are not clear why this assumption has been made:** Paragraph 3 of Article 22f/Article 24f only mentions 'elements' of 'information' (referring to the records mentioned in the previous 2 paragraphs) kept by market participants being made available to regulators. It is quite clear to us that this does not refer to a regular transparency requirement.

The CDWG is currently exploring views held by some sections of the banking community that the scope of MAD should be widened to cover MTFs trading in commodities. The CDWG is certain that any changes in this regard should not affect existing insider dealing or insider information provisions in MAD concerning commodities business. We believe that the MAD review is the most appropriate process in which to review these questions.

**C. Fact-Finding**

1. ***How many of the following also fall under the definition of investment firms under Article 4(1)(1) of Directive 2004/39/EC (MiFID):***
   (a) ***undertakings active in 'supply' of electricity within the meaning of Directive 2003/54/EC (Art 2.19)?***
   (b) ***undertakings active in the 'supply' of natural gas with the meaning of the Directive 2003/55/EC (Art. 2.7 and 2.8)?***

We believe that these definitions, including, as they do, undertakings involved in the function of 'sale' and 'resale' (both of which are covered by 'supply' under the Directives) of electricity and gas to 'customers', would include many MIFID investment firms participating in commodities markets (the definition of 'customer' in each Directive suggests that 'customer' would include other wholesale market counterparties buying electricity and gas from the 'supply undertaking').

2. ***What are the existing record-keeping obligations with respect to transactions in electricity and gas derivatives to which investment firms are subject by reason of MiFID? Consider both the transaction reporting obligation of firms under Article 25 of MiFID as well as the record-keeping obligations under Article 13(6) of MiFID.***

MIFID investment firms are subject to transaction reporting requirements for instruments admitted to trading on regulated markets. These would include exchange-traded electricity and gas derivatives, but not OTC derivatives. The reports should 'include details of the names and numbers of the instruments bought or sold, the quantity, the dates and times of execution and the transaction prices and means of identifying the investment.' There was much debate on the practical application of MiFID level 2 rules in this regard last year, focusing on the practicalities of reporting, with the challenges for companies in complying with these requirements exacerbated by the proposal to include data which would be of use to regulators for data sharing purposes but which had no practical use or meaning in the energy markets (for example using ISIN and CUSIP codes). The only practical solution was (and remains) for exchanges to report centrally on behalf of firms using existing exchange identifiers. Agreement on this was reached (following discussions with industry) by CESR in Autumn 2007.

This is not to say that firms do not keep records of transactions– most do for a variety of reasons but, depending on their deal capture systems, will do so in non-identical formats. Article 13(6) of MIFID requires investment firms to keep records of all 'services and transactions undertaken' – whether on exchange or OTC. Article 25 of MIFID further states that such records should be kept for 5 years.

Regulators should also be aware that for many market participants, the requirement to record the time of transactions will represent a new requirement, extra to the criteria already recorded in existing internal software systems. For more structured or long term supply and derivative

contracts, the time of the transaction is not a particularly important item of information. We are concerned about this requirement.

*3. What (regulatory) authority oversees activities in energy markets in EU Member States?*

*Energy* regulators in specific EU Member States include:

- UK – Ofgem
- France – CRE
- Spain – CNE
- Belgium – CREG
- Netherlands – DTe
- Italy – AEEG
- Sweden – Energimarknadsinspektionen
- Denmark - Energitilsynet
- Finland – Energiamarkkinavirasto
- Austria - Energie-Control GmbH
- Germany – Federal Network Agency (BNetzA) and the Regulatory Authorities of the German States (Landesregulierungsbehorden).

CESR will be in a position to share information with ERGEG concerning competent authorities involved in financial regulation of commodity and exotic derivatives trading, following the 'initial assistance' provided to the European Commission in August 2007, which covered this topic.

CESR and ERGEG should also consider the role of competition authorities in various Member States, who play a role in ensuring sound competitive conditions are in place in energy (and other) markets.

**D. Record-Keeping**

***4. Do regulators believe that there should be a difference between the proposed record-keeping obligations under the proposed amendments to the electricity Directive and gas Directive and the existing record-keeping obligations with respect to transactions in electricity and gas derivatives to which investment firms are subject by reason of MiFID (Articles 25 and 13(6))?***

Firms regulated under MIFID are already subject to record-keeping obligations (5 years) with respect to trading in commodities instruments falling within the definition of financial instrument under MIFID.

Power and gas firms who currently benefit from MIFID exemptions do not have to comply with these requirements.

The proposed amendments to the Electricity Directive and Gas Directive under the 3rd Energy Package aim to address all supply undertakings with a wide range of data to be retained, relating to all transactions in electricity/gas supply contracts and electricity/gas derivatives with wholesale customers and TSOs.

CDWG members are willing to support retaining data on both supply contracts and derivative transactions for up to 5 years, presuming cost-efficient and proportionate rules or principles can be put in place for retention of this data. This data could then be provided, on request by regulators, if e.g. they suspect wrongdoing of some kind.

Following the debate that took place around transaction reporting in the context of MiFID, energy firms are wary of any new regulatory initiatives to impose reporting requirements. There is an inbuilt tension between the way the firms hold data and the way in which regulators would ideally want data to be reported. Firms' interests in this regard relate to the importance of having a robust audit trail of transactions – they do not focus on the uniformity of data or unique identifiers (the likely priority of regulators). It would potentially represent a disproportionate and costly burden to expect firms to invest in new systems or new ways of working purely to meet regulatory ideals.

5. ***Pending the outcome of the legislative process in respect of the proposed Directives amending Directives 2003/54/EC and 2003/55/EC (the Third Energy Package), what methods and arrangements for record-keeping do CESR and ERGEG consider the Commission should specify as guidelines under this legislation for:***

   ***(a) transactions in electricity and gas supply (spot) contracts? (To the fullest extent possible this should be a harmonised specification.) If there are any deviations from obligations relating to commodity derivatives already applicable to investment firms, these should be justified;***

   ***(b) transactions in electricity and gas derivatives contracts? (To the fullest extend possible this should be a harmonised specification.) If there are any deviations from the recommendations in a), these should be justified.***

   ***In answering this question, CESR and energy regulators are asked to consider specifying a single transactions record format based on the content and data to be provided as per Table 1 of Annex 1 of Regulation EC 1287/2006.***

The CDWG would like to underline the importance of finding a cost-efficient and proportionate methodology for record-keeping obligations. Imposing a requirement for a single transactions record format could entail major investment in corporate software, at minimal benefit to regulators or the market.

The CDWG believes that in deciding on these methods and arrangements, regulators should take account of current industry practices for retaining these records. Many CDWG members, for example, already retain this data for e.g. 'other' regulatory, legal or risk management reasons (e.g. compliance with the Sarbanes-Oxley law, where applicable) or for tax or audit reasons. Records are kept in the form of "confirmations" pursuant to relevant industry master agreements (e.g. EFET and ISDA agreements) and electronic form in deal capture systems.

The CDWG does not believe that there is a case for new transaction reporting requirements or pre- or post-trade transparency requirements being imposed on market participants. If no such rules are proposed following the current review, we would suggest that a 'single format' for record-keeping would not be necessary (presumably standardisation of formats is beneficial for the purposes of rapid analysis of large amounts of data rather than for analyzing records on a small number of transactions, requested where regulators suspect wrongdoing). We would also suggest that reduction of all data down to a single format may not actually be that helpful, given the customised nature of many transactions in the OTC market (for example many OTC transactions, especially in power, use bespoke "shapes" reflecting half-hourly supply matrices, resulting in very large reports (48 half hours by the number of days in the contract) - it would be impossible to report these in a uniform manner).

Rather, we believe that the obligations placed on firms for data retention should be principles-based. Firms should simply be required to retain the data in a format that will e.g. ensure accurate and helpful information for regulators when these records are requested. We believe these principles should apply for transactions in gas and electricity supply contracts and for gas and electricity derivatives contracts.

Naturally, regulators should ensure safeguards are in place when information is requested, to ensure the confidentiality and security of data.

The CDWG would also like to point out that, in some spot markets (the electricity spot market, for example), most contracts are traded on exchange, and regulators can access this information directly from the exchanges – thus providing a visible signal for prices applied to end customers.

6. ***How would this information be most efficiently kept at the disposal of authorities as mentioned under paragraph 1 of Article 22f/24f in the case of spot transactions and non-investment firms?***

As mentioned, we believe that the data should be retained by firms in accordance with principles facilitating understanding by regulators of this data where requested. Beyond this, however, we feel that the actual method of data keeping should be left to each individual company.

Please note the comments above (question 5) on spot pricing in electricity markets.

7. ***How would securities regulators most efficiently provide information to energy regulators pursuant to paragraph 7 of Article 22f/24f?***

Regulators of the physical and derivatives markets should ensure that firms do not have to duplicate compliance efforts.

We believe it is for securities and energy regulators to decide how they might best exchange information (without prejudice to the principle that burdensome and disproportionate requirements should not be imposed on firms solely with the aim of facilitating this easy exchange).

8. ***Which securities regulator would most efficiently be responsible for such provision in the case of investment firms with more than one branch?***

The home state securities regulator responsible for the Member State in which the investment firm is headquartered should be responsible for the provision of relevant data to the relevant home state energy regulator, on request (whether those records relate to MIFID-scope commodity derivative transaction reports, or trade data requested on a case-by-case basis by other securities or energy regulators on instruments or physical market transactions that are outside the scope of MIFID).

9. ***Would it be feasible and efficient to employ the Transaction Reporting Exchange (TREM) or a similar electronic system to exchange this data?***

The considerations in this section of the CESR-ERGEG Call for Evidence relate to record-keeping obligations, for the purposes of requests for data on a case-by-case basis by regulators – and not a permanent exchange of data. We therefore believe that the deployment of the TREM is not necessary.

Apart from this consideration, we would be concerned if an assumption was made that a system designed for transaction reporting for exchange traded derivatives in the context of MIFID was de facto appropriate for electricity and gas markets and electricity and gas OTC derivative markets, with all of the costs that would be implied by such a requirement.

10. ***Is there a case for data to be forwarded from energy regulators to securities regulators on an automatic basis? If so, what data?***

If there is any data to be forwarded from energy regulators to securities regulators, we do not believe it should be done on an automatic basis. Although firms would be required to keep records (and CDWG member firms support this suggestion), they should not be required to forward trade data on an automatic basis to regulators (as in transaction reports). Data should only be provided to regulators on a case- by-case basis.

Where data is requested from investment or commodity firms by e.g. energy regulators and forwarded on to securities regulators, safeguards should be in place to ensure that this data is treated confidentially and securely by regulators. No commercially sensitive data should be published.

The CDWG would also observe that regulators should be certain of what they would achieve by sharing such data automatically and that they would have the resources to interpret, use, store and protect this data.

***E. Transparency***

*11. What guidelines and arrangements do energy regulators propose for the making available of aggregate market data by them under paragraph 3 of Article 22f/24f?*

It is not clear to the CDWG how or why records kept by firms and requested (on a case-by-case basis) by regulators would be made available to the market in a manner that would be (a) helpful to the market and (b) respectful of commercial sensitivities.

The placing of this paragraph (3) in Article 22f of the Electricity Directive and Article 24f of the Gas Directive seems to suggest that records kept by firms (these Articles deal with record-keeping) would be made available to the market by regulators. The question put to respondents here suggests that aggregate market data would be provided to market participants. Paragraph 3 of each Article only mentions 'elements' of this data being made available to market participants.

The CDWG would welcome more clarity as to how regulators would gather this aggregate market data. It appears as if there may be some assumption of an automatic transaction reporting or transparency requirement falling on firms that would allow regulators to gather this data. We would have major concerns if such an assumption had been made.

The CDWG does not have any objection in principle to the provision of aggregate market data to market participants – but a cost-effective method of doing this must be assured. In this regard, regulators should be conscious of the bespoke and confidential nature of many OTC transactions in these markets, which may render the resulting data difficult to understand and interpret. CDWG members are concerned that aggregation and collation of vast amounts of data by regulators will prove a difficult task, and that, by the time this task has been accomplished, such data is likely to be of historic value only. We fear that this reality could lead regulators to impose uniform data requirements on firms which do not tie in with systems currently in place in these firms.

As mentioned elsewhere in this paper, the CDWG supports the release of data regarding the use of essential infrastructure in electricity and gas markets.

The CDWG would also like to underline the need for regulators to very carefully review the impact of any transparency requirements they may be considering on the obligations placed on market participants under the Market Abuse Directive (MAD). The MAD prohibits market participants who possess 'inside information' from trading in financial instruments (including futures) admitted to trading on a 'regulated market' (and from disclosing that information or encouraging others to deal in those instruments, except in limited circumstances). Thus, a person is regarded as having inside information if he has non-public information of a precise nature relating, directly or indirectly, to e.g. gas futures if this information is 'required to be disclosed in accordance with legal or regulatory provisions, market rules, contracts or customs on the relevant underlying commodity market or commodity derivatives market' (Directive 2004/72 EC implementing MAD). Thus, the creation of new disclosure requirements concerning electricity and gas supply contracts and derivatives will automatically extend the scope of the insider dealing restriction. Persons who have or have had pre-publication access to that information (e.g. in draft form), or possibly have the information from which it is derived, may be restricted from dealing in related in-scope (of MAD) derivatives on the basis of that information until it has been

made public. Firms required to supply information in this way would be at a significant disadvantage as against other market participants who are not similarly constrained.

***12. What requirements, deriving from national law, are currently put on energy traders, brokers or exchanges to publish information 'post-trade', for example on publishing traded volumes, prices etc.?***

National energy regulators are best-equipped to answer this question, as the answer to this question varies on a country-by-country basis.

In Germany or Spain, for example, post-trade information is compulsorily published by exchanges – but not by brokers or energy traders.

Many energy companies voluntarily publish generation data such as production or unplanned outages for the purpose of market outages.

***13. What requirements, deriving from national law, are currently put on energy traders, brokers or exchanges to publish information 'pre-trade', for example on publishing bids to organised markets?***

The situation in this regard varies from country to country. National energy regulators are best-equipped to answer this question, in our view.

***14. Is there a difference in transparency requirements for spot trading compared to future and forward trading? If so, why?***

Under MIFID, pre- and post-trade transparency requirements are only required for equities traded on regulated markets or MTFs. A review (mandated by MIFID) of whether or not similar transparency requirements should be mandated for other asset classes (ranging from cash bonds to OTC commodity derivatives) has yet to be concluded, but seems to be moving towards the conclusion that there is no case for any new regulation mandating pre- or post-trade transparency in any of these other asset classes - though the European Commission and CESR have encouraged a couple of developing industry initiatives designed to increase transparency in parts of the bond markets where there is a significant retail presence.

Thus, at EU level, pre- and post-trade transparency requirements do not apply to MIFID-scope derivative instruments of any kind (including exchange-traded MIFID-scope commodity derivatives) unless required under super-equivalent national legislation.

MIFID transaction reporting requirements apply to futures and other contracts listed on regulated markets (where, as we have already explained, the compromise reached on this issue in 2007 was for the exchanges to report centrally on behalf of firms). They do not apply to spot trading (expressly excluded from MIFID) or OTC forwards (which, if they are transacted for 'commercial purposes' are out of MIFID scope).

In the absence of further EU-level rules on transparency or transaction reporting around spot trading, futures or forwards, differences in treatment may crop up at national level, according to national approaches.

The CDWG is not aware of any good reasons why EU-level transparency requirements should be imposed on spot, forwards or futures traders. If there was a case for application of transparency requirements to futures, this would have been stipulated under MIFID. In the case of forwards and spot trading, trading in these commodities is a key part of the risk management processes of firms. We believe that imposing transparency rules in this context would do more harm than good, in terms of liquidity and in terms of undermining risk management practices.

***15. Is there a difference in transparency requirements for exchange trading compared to OTC trading? If so, why?***

Concerning trading of financial instruments, MIFID pre- and post-trade transparency requirements apply only to equities. As mentioned in our response to Question 14, an EU review (mandated by MIFID), involving CESR, of whether or not similar transparency requirements should be mandated for other asset classes (ranging from cash bonds to OTC commodity derivatives) has yet to be concluded, but seems to be moving towards the conclusion that there is no case for any new regulation mandating pre- or post-trade transparency in any of these other asset classes

One of the key justifications for this distinction, we believe, relates to the profile of investors in, on the one hand, equities markets (where retail investment is a significant factor) and, on the other, the wholesale, professional nature of the other markets that were under examination in the review. Retail investors arguably need equal access to information to that afforded to 'sophisticated' participants in equities markets. Retail participation is not a major factor in e.g. OTC derivatives markets and the wholesale counterparties that characterise participation in these markets do not necessarily need nor want mandatory transparency requirements. Certainly, as is widely acknowledged, retail participation in commodity and commodity derivative markets (such as those in electricity and gas) is not in evidence, other than where such participation is intermediated by professional participants. We therefore consider that commodities and commodity derivatives lie at the opposite end of a spectrum of retail participation, with equities at the other end and (generally speaking) bonds somewhere in between.

We would also add that, in the case of OTC trading of physical commodities and of commodity derivatives no evidence of any market failure in relation to transparency has been identified by any EU agency (including in the DG COMP Energy Sector Inquiry – please see our response to question 19).

MIFID transaction reporting requirements apply only to instruments admitted to trading on regulated exchanges. Thus, this covers exchange-traded derivatives – CESR will be aware of the compromise agreed in 2007 for exchange-traded derivative transaction reports. Futures are therefore covered by transaction reporting requirements.

Transaction reports are not required for OTC derivative contracts (linked to commodities or otherwise) falling within the scope of the MIFID financial instruments definitions.

There are other good reasons not to apply transparency requirements to OTC trading of physical electricity and gas and of electricity and gas derivatives. These include

- (as mentioned above) no evidence of market failure;
- (as mentioned above) the lack of significant retail participation in these markets;
- Transparency is not an end in itself, but rather a means towards market efficiency. The goal should be an 'optimal' level of transparency for the functioning of commodity and commodity derivative markets, rather than necessarily a 'high' level of transparency. The nature of each type of market needs to be considered. 'Optimal' transparency encourages participation in wholesale markets (in general) by customers and liquidity providers. Certainly, we believe, stringent disclosure requirements could cause more volatility in the physical commodities and derivatives markets as participants exploit (or are affected by) disclosures on market positions (damaging the interests of those seeking to hedge commercial risk, in particular). Liquidity would be reduced, with markets becoming less efficient, displaying wider bid-offer spreads, greater price movements in response to large trades, lower resiliency in the face of price movement and generally less informative pricing. Any transparency imposed on market participants must be highly sensitive to the nature of the relevant market (so as not to over-expose market makers).
- Many trades in these markets are of a highly customised nature (one of the key differences with fungible, comparable and standardised exchange instruments). This lack of comparability would undermine the (supposed) benefits of transparency requirements. We cite as an example power and gas trades that include in their terms elements such as access to cross-border interconnections, indexation with fuel or CO2 prices, and other elements that make them frequently non-standard, or trades (normally non-standard) conducted under Virtual Power Plant auctions, whose prices and terms cannot be easily compared to exchange-traded products.

Transparency requirements on OTC trading would represent a new costly and burdensome requirement for participants in these markets. Serious consideration would need to be given to the possibility that this would reduce participation in markets for prohibitive cost reasons, and that disproportionate regulation could drive participants to consider investment in other jurisdictions.

***16. What information, other than required by law and regulation, is made public by energy traders, brokers, information services or exchanges?***

A number of independent information services are provided to energy and related markets, on a commercial basis.

Services such as those provided by Platts, Bloomberg, Reuters, Heren and Argus provide information to subscribers, which they take on consideration in their day-to-day business decisions. Such information includes market-related news stories, market analysis, weather data, exchange prices, benchmark prices, data on scheduled and unscheduled outages etc. The information can be provided in electronic format and in [close to] real-time or periodically

(ranging from daily to monthly). Service providers also provide extensive database analytical tools covering inputs into market price, from exchange prices to capacity levels.

Many exchanges also publish hourly volumes and prices, including

- APX - Netherlands, UK
- EEX – Germany, Austria
- Nordpool – Denmark, Finland, Germany
- Omel – Spain, Portugal
- Powernext – France

Many exchanges also offer information on current bid, current offer, volume of bid, volume of offer, last traded price, total traded volume and, usually, open interest as part of their continuous trade in forward prices offer.

Brokers also offer continuous information on bids, offers, associated volumes (of bids and offers), transaction prices (and volumes traded), as well as daily reports and other historical data as part of their offer in continuous trade of spot and forward products. Such brokers includes ICAP Energy, Spectron, Tullett Prebon Energy etc.

The following exchanges offer continuous trade in forward products, including information on current bid, current offer, volume of bid, volume of offer, last traded price, total traded volume and, usually, open interest: EEX (Germany, France), Endex (Netherlands, Belgium), ICE (UK), Nord Pool (Denmark, Finland, Norway, Sweden), Powernext (France). EEX and Nordpool also offer information on planned and unplanned production outages.

Various other service providers (e.g. Dow Jones, Bloomberg) also provide benchmark prices and analysis, or in the electricity market (e.g. Genscape) data on supply and demand in European electricity markets.

The CDWG also highlights that in some markets, market operators, may represent (hitherto) untapped potential sources of aggregated market data. We believe that regulators should explore the scope for accessing such information as an alternative to further reporting burdens on market participants.

As mentioned elsewhere, we believe that TSOs and generators can also potentially provide different types of information, including status of transmission networks, availability of interconnection capacity, aggregated load and supply, and status of generation plants etc.

We urge regulators to conduct a full survey of the information that is already potentially available from such sources before imposing challenging compliance requirements on firms.

***17. Is access to information on traded volumes and prices equal for all parties active in that market?***

All of the above information is available on a commercial basis (from e.g. brokers, exchanges and data service providers), indiscriminately, to all market participants.

***18. If not, is unequal access to or general lack of information on trading causing distortion of competition?***

The CDWG acknowledges that some degree of information asymmetry is unavoidable in commodity markets given the involvement of some market participants in the underlying physical markets. The markets themselves are primarily wholesale markets, and counterparties, being both aware of the potential for asymmetries and having a high degree of industry expertise, are considered capable of protecting their own interests in this regard. The CDWG agrees with the analysis on this point in the recent UK Discussion Paper on the EU review of financial regulation of commodity and exotic derivatives.[1]

The 3rd Energy Package proposals address transparency in gas and electricity, imposing new transparency requirements on supply undertakings active in electricity and gas markets e.g. increased transparency on gas stocks, on forecasts of demand and supply and costs for network balancing. The CDWG supports these requirements, as a helpful improvement to levels of transparency for physical market fundamentals which should inform the considerations of participants in derivatives markets.

We believe that greater disclosure of information around essential infrastructure would enhance transparency in gas and electricity markets to the benefit of these markets, ensuring greater competition, more liquidity and more efficient wholesale price formation.

***19. In light of the findings in the Commissions Sector Inquiry on energy and the subsequent study of the electricity wholesale markets, please consider……***

We would like to preface our response to this section by addressing the purpose and conclusions of the European Commission's Sector Inquiry on energy.

The purpose of the Sector Inquiry was to analyse where market participants currently see major deficiencies that still need to be overcome. Issues identified by market participants were grouped under 5 headings:

1. Concentration and market power,
2. Vertical foreclosure,
3. Lack of market integration,
4. Lack of transparency,
5. Price formation

[1] Please see http://www.hm-treasury.gov.uk/media/C/9/commodities_report.pdf - on this issue, see paragraph 4.25 of this document.

We would like to highlight that at no point does the Sector Inquiry demonstrate evidence of a market failure as regards transparency in wholesale supply contracts and derivatives contracts in electricity and gas.

Where the report calls for action to combat a lack of transparency in electricity and gas markets, it refers not to transparency in wholesale electricity and gas supply contracts or derivatives contracts, but rather to use of essential infrastructure, such as gas transit pipelines or electricity interconnectors.

The report does refer to the use of derivatives in the section on 'price formation' but doesn't identify any evidence concerning failings in wholesale physical and derivative markets. Rather it refers to 'limited trust' by users in price formation mechanisms. We believe that, in line with better regulation principles, this is not a sufficiently rigorous conclusion to justify potentially damaging imposition of transparency requirements in wholesale trading markets.

Reading of the report on the Electricity market would suggest that problems in price formation in these markets are a symptom of other problems in electricity markets, in particular

- ***Concentration and market power*** – allowing e.g.
    - net excess of generation for a few players (compared to their retail supplies) and excessive bidding.
    - Price increases caused by large operators withdrawing capacity.
- ***Vertical foreclosures*** – where e.g.
    - Vertical integration of generation and retail within energy companies reduces the need for these companies to trade on wholesale markets, reducing liquidity in these markets.
    - This in turn leads to high volatility of prices, increasing costs for hedging; and
    - This in turn leads to a lack of trust that the exchange price reflects the overall supply and demand balance in the wholesale market.
    - Companies active in electricity generation and/or supply that also own transmission or distribution network assets can use this monopoly position to prevent or limit competition in other areas of the value chain. This raises competitors' costs, causing price squeezes. Furthermore, these vertically integrated companies withhold essential information, providing it only to affiliated companies.
    - The lack of transparency as regards network constraints combined with the obligation on applicants to contribute to network reinforcement creates considerable leeway for vertically integrated companies to raise their rivals costs for bringing new capacity online or even to make this *de facto* impossible without an outright refusal of network access.
- ***Lack of market integration***, where the report concludes that
    - there is insufficient interconnecting infrastructure between national electricity systems;
    - There are insufficient incentives to improve cross border infrastructure;
    - There is inefficient allocation of existing capacities, and
    - Different markets are incompatible (e.g. differences between balancing regimes, nomination procedures, and differences in opening hours of power exchanges).

- ***Lack of transparency*** i.e information considered necessary to trade: the report concludes that there are shortcomings in this regard in most Member States relating to information concerning expected demand, supply and network issues (this deficiency of transparency does not refer to supply contracts or derivative transactions). [2]Priorities for information provision in this context are listed (in order of priority) by the Commission i.e. relating to
    - Technical availability of interconnectors
    - Technical availability of TSO networks
    - Generation (capacity)
    - Balancing and reserve power
    - Load
    - Generation (production) – the least important of these priorities.
- ***Price formation*** – where the Commission opines that
    - in certain Member States the recent increases of electricity prices can be explained by the rise of gas prices used in marginal plants.
    - There is a divergence of opinion on the extent to which the value of $CO_2$ allowances is priced into electricity prices – the Commission is keen to ensure that the EU Emissions Trading scheme facilitates new generators' use of low emitting technologies and does not act as a barrier to entry.

Thus to summarize, the Sector Inquiry report:

- Does not include any evidence of abusive behaviour in wholesale markets for trading of supply contracts or derivatives in electricity gas, nor of failure in these markets;
- Refers rather to a long list of potential issues in e.g. electricity markets, which themselves contribute to inefficient price formation, which could be significantly resolved through publication of data around use of essential infrastructure such as gas transit pipelines or electricity interconnectors.

We believe this latter point should be the focus of new transparency requirements for wholesale electricity and gas markets.

***(a) …. whether, pending the outcome of the legislative process in respect of the proposed Directives amending Directives 2003/54/EC and 203/55/EC, greater EU-wide pre- and/or post-trade transparency rules for electricity and gas supply contracts (physical and spot trading) and electricity and gas derivatives would contribute to a more efficient wholesale price formation process and efficient and secure energy markets;***

We do not agree that more transparency and more information is necessarily better, in *any* market, for market functioning. The benefits of transparency vary according to the types of market involved (see our answer to question 15). We believe that new transparency requirements

[2] There is some suggestion from market participants that excessive transparency requirements in oligopolistic markets could actually facilitate collusion between these major suppliers – for this reason the Commission suggests that publication only of aggregated market data would not facilitate collusion and would protect the commercial interest of small market players.

in wholesale markets in electricity and gas supply contracts and derivatives would undermine price formation processes by decreasing liquidity and increasing volatility in these markets.

Our reading of the Sector Inquiry report suggest that there is no evidence that a lack of transparency concerning electricity and gas supply contracts nor electricity and gas derivatives contracts is the main factor undermining an efficient price formation process, and that, rather, publication of data around use of essential infrastructure such as gas transit pipelines and electricity interconnectors would be more effective in addressing this problem.

The conclusions of the Sector Inquiry suggest that more information about technical availability of interconnections and technical availability of TSO network is needed to increase efficiency and security in electricity and gas markets. We believe that market participants need information facilitating prediction of the likely evolution of supply and demand fundamentals and an ability to move energy around the transmission system. Access to information about electricity transmission and generation, gas transportation and gas storage allows new entrants to benefit in practice from third party access. Data about the use of this infrastructure assists efficiency and liquidity in the market and reduces risk.

We believe that regulators should focus their efforts in this context.

***(b) whether such transparency arrangements could be expected to effectively mitigate the concerns identified in the Sector Inquiry above;***

The key problems identified by market participants in the Sector Inquiry (vertical foreclosure, market concentration, lack of market integration, transparency (in the sense meant in the Sector Inquiry report) or price formation level are not rooted in (non) disclosure of information about market wholesale transactions.

When the Sector Inquiry report refers to transparency, it refers to ‘a lack of reliable and timely information’ on aspects such as ‘data relating to network availability, especially for electricity interconnections and gas transit pipelines’ as well as ‘operation of general capacity and gas storage’. More information on this infrastructure will ensure enhanced competition among market actors. Published information on these aspects must be the same across Europe.

In relation to the “market monitoring” or the disclosure of information about the state of the market and wholesale transactions, the Sector Inquiry states that “(…) *Customers have little trust in the functioning of wholesale [electricity] markets. They suspect market manipulation on the spot and forward markets by large generators to be the main reason for recent price increases…*”. While it is true that this may be the perception, the report does not actually provide any evidence of market failure, and rather suggests that other structural flaws in energy markets are the main contributory factors to this dissatisfaction.

The report also suggests that one of the main factors in wholesale electricity and gas market prices in the internal market in recent years was the opportunity cost of carbon emission allowances.

Finally we think that regulators [and market participants] can learn as much as they need to know in normal circumstances about price formation from published exchange data and from the trade press (who construct their own OTC market price indices.) Only in circumstances where there exists *prima facie* evidence of an abuse of dominant position, of collusion or of other market abuse, should it be necessary to demand specific transaction price data from producers and/or traders.

***(c) whether uniform EU-wide pre- and post-trade transparency could have other benefits;***

Well-functioning wholesale power and gas markets are an essential part of an efficient EU internal market in energy. Electricity and gas are network-bound energy commodities, and this necessitates a high degree of transparency about use of physical infrastructure. Transparency about use of such infrastructure reduces risk, provides confidence and allows efficiency, liquidity and security of supply to improve.

The release by TSOs, producers and large consumers of demand, transmission and generation data is the key factor in enhancing market participants' ability to analyse likely market developments and to participate in forward markets. It is a lack of transparency regarding *this* data which forces participants to risk their capital on events that they do not fully understand - increasing risk premiums and reducing liquidity. The ensuing costs then manifest themselves eventually in prices charged to consumers.

***(d) whether additional transparency in trading could have negative effects on these markets, for example could liquidity in these markets be expected to decrease? Is there a risk that trading could shift to third countries to escape regulation?***

***(e) If you believe that there are risks arising from additional pre- and post-trade transparency requirements, how do you believe that these risks can be mitigated (e.g. aggregation, delay in publication, anonymity)?***

If disproportionate transparency requirements are imposed on supply and derivative contracts in electricity and gas, liquidity in these markets can be affected and trading could move to third countries to escape regulation. Such requirements represent an additional cost and barrier to market entry, and put commercial interests at risk.

We believe it is of key importance that common rules apply across Europe, and that overlap between requirements arising from energy regulation and from financial regulation is avoided.

Currently traders have no claim to financial information or any commercial information about other traders' transactions, except for the very limited purpose of checking whether TSOs are properly allowing market access.

Of greater concern to traders in the electricity and gas sectors is the lack of cross border co-operation between transmission system operators (TSOs). This failure to harmonise extends in

electricity markets, for example, to their methods of congestion management, their assessment of available transmission capacity at borders and their isolated organization of national intra-day and balancing markets. These important aspects of market integration have not yet been resolved on a pan European scale, nor within most regions. On the gas side, whilst policymakers and regulators increasingly emphasize the need for fully transparent, simple and cost-reflective third party access regimes, there remain formidable barriers to entry. These barriers are partly caused by artificial complexity and a lack of disclosure by these TSOs, which continue to deter new entrants.

Wholesale market participants fear financial regulation of commodity derivative transactions would simply create a further barrier to entry into illiquid and fragmented continental European power and gas wholesale markets. Proposals that such participants should compulsorily disclose to national regulators (or indeed publish) details of market participants' OTC wholesale power and gas transactions would cause considerable concern in the electricity and gas trading community across Europe.

## F. Market Abuse

***20. Is the scope of Directive 2003/6/EC on insider and market manipulation (market abuse) such as to properly address market integrity in the electricity and gas markets? Would the assessment be different if greater transparency obligations in line with the analyses above were adopted? What suggestions do regulators have to mitigate any shortcomings?***

The review of the Market Abuse Directive would seem the obvious workstream through which to look at the regulation of commodity firms for the purpose of MAD.

The CDWG is aware of the concerns of banks and investment firms, as expressed by the London Investment Banking Association (LIBA), concerning what banks and investment firms see as a "difference in regulatory grip" on the behaviour of commodity firms in the context of market integrity. It is our understanding that banks believe that this amounts to an unfair competitive advantage for some unregulated market participants over banks (and indeed commodity firms who are publicly quoted companies in Western Europe and therefore subject to the strong imperative to preserve their reputation).

Banks and investment firms would like to ensure that regulators have the powers to investigate when aberrant behaviour is apparent and enforce proper market standards. They propose that a useful, practical solution in this regard would be to apply the MAD regime to commodity MTFs as Prescribed Markets – thus, in their view, achieving this end without extensive re-writing of the whole MAD regime. The scope in this regard would be behaviour 'in relation to' MTFs, not narrowly trading on them, but should not affect directly or indirectly the existing insider dealing and insider information provisions.

LIBA has expressed the view to the CDWG that it could have more confidence in the level of regulation around commodity firms for the purpose of MIFID and CRD if the relative standard of regulation for market integrity in the commodities area was addressed in this way.

LIBA is cogniscent of the scope for unintended consequences in such an exercise (as in any potential change in regulation) but would welcome a commitment to the principle underlying this proposal, before any full consideration is undertaken.

The CDWG is currently considering the LIBA proposal in this regard, and exploring the scope for a common position with LIBA on this issue.

Please note our comments (see question 11) on possible unintended consequences resulting from new transparency requirements under the 3rd Energy Package on the scope and impact of the Market Abuse Directive.

## G. General

21. ***What timelines should be built into the implementation of any of the above recommendations?***

We suggest that timelines for implementation of any recommendations should only be agreed after (a) clarity is provided on what the scope of such recommendations would be and (b) discussion with the market participants who would be forced to comply with these requirements.