



Ref.: CESR/08-140

CESR/ERGEG CALL FOR EVIDENCE ON RECORD KEEPING, TRANSPARENCY, SUPPLY CONTRACTS AND DERIVATIVES FOR ELECTRICITY AND GAS

Background

In December 2007 the European Commission issued a joint mandate to the Committee of European Securities Regulators (CESR) and the European Regulators Group for Electricity and Gas (ERGEG) with a Call for Technical Advice related to Articles 22f and 24f and Recitals 20 and 22 respectively in the two proposals for Directives amending Directive 2003/54/EC and Directive 2003/55/EC (The Third Energy Package). CESR and ERGEG are requested to deliver their technical advice in two parts, by the end of May 2008 and by the end of December 2008 (see Annex 1).

CESR and ERGEG are being asked to jointly give advice on issues concerning record keeping and transparency of transactions in electricity and gas supply contracts and derivatives. The aim of the Call for Advice is to find out if additional measures are necessary with respect to transparency in energy trading, as well as provide the Commission with the adequate technical background to adopt the guidelines on record keeping under articles and recitals referred to above.

Firstly, CESR and ERGEG are requested to conduct fact-finding on how many undertakings active in 'supply' of electricity and natural gas are within the scope of the Markets in Financial Instruments Directive (MiFID). They are also asked to provide information on what the investment firms' existing record-keeping obligations with respect to transactions in electricity and gas derivatives are, as well as what authorities oversee trading activities in energy markets in various EU Member States.

Furthermore, CESR and ERGEG are asked to provide information on the existing pre- and post-trade transparency requirements, deriving from national law, that energy traders, brokers and exchanges are subject to. In addition, they should describe the possible nature and reasons for the differences in transparency requirements for spot trading, compared to future and forward trading, and for exchange trading compared to OTC trading. Information is also sought on what information, other than that required by law or regulation, is made public by the above entities and information services and whether access to information is equal for all parties active in the market. In case of possible unequal access to or general lack of information, CESR and ERGEG are asked to provide their view on whether this is causing distortion of competition.

CESR and ERGEG are requested to consider the possible benefits of 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. Similarly, they should also assess whether additional transparency in trading could have negative effects on these markets (for example by decreasing liquidity or shifting trading to third countries to escape regulation) and how these possible risks could be mitigated.

Advice is also sought from CESR and ERGEG on a possible clarification of the scope of the Market Abuse Directive in relation to trading in commodities and commodity derivatives.

The above advice is due in the end of May 2008. In addition, by the end of December 2008 advice is requested on record keeping requirements, especially on whether there should be a difference between the record keeping obligations under the proposed amendments to the electricity and gas Directives 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. Furthermore, CESR and ERGEG should provide their advice on the methods and arrangements for record keeping of transactions in electricity and gas supply (spot) contracts and transactions in electricity and gas



derivatives contracts. In addition, advice is sought on efficient methods to exchange this data between different regulators.

Finally, CESR and ERGEG are asked to provide advice on what timelines or delays should be built into the implementation of any of their recommendations.

The Call for Advice indicates that in their analysis, CESR and ERGEG should apply the framework for impact analysis recently drawn up by the 3 Level 3 Committees (Committee of European Securities Regulators, Committee of European Banking Supervisors and Committee of European Insurance and Occupational Pensions Supervisors).

This Call for Advice is to run in parallel to the other stream of work where Commission has issued a joint mandate for advice to CESR and The Committee of European Banking Supervisors (CEBS) on the possible review of exemptions for some commodity firms from MiFID and Capital Adequacy Directive (CAD). Thus CESR and ERGEG are asked to consider the earlier advice on commodities markets and trading given separately by CESR and CEBS to the Commission as well as the views expressed during the Commission's Call for Evidence on commodities and the conclusions reached in the subsequent feedback statement.

Call for evidence

CESR and ERGEG are inviting all interested parties to submit their views regarding the Call for Advice and especially the questions contained in its Annex (see Annex 1 of this document).

Stakeholders should be aware that the Commission's questions, included in the Annex, are addressed to CESR/ERGEG. As such, not all the questions will be applicable to all stakeholders. When responding to this call for evidence, stakeholders should use their discretion to select those issues on which they are best placed to comment. In particular, we would refer respondents to the questions raised in section E of the annex.

All contributions shall be submitted via e-mail to ERGEG (mail to fis@ergeg.org) and/or online via CESR's website under the heading Consultations at www.cesr.eu by 18 March 2008. Non confidential contributions will be published on the CESR and ERGEG websites. Respondents to this Call for Evidence should, however, endeavour to provide any confidential material in annexes that can be separated from publishable non-confidential material.



EUROPEAN COMMISSION
Internal Market and Services DG

Director-General

Brussels, 21-12-2007
MARKT G3/HH/cr D(2007) 4483

Mr Eddy Wymeersch
Chairman
Committee of European Securities
Regulators
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Subject: Request for joint CESR/ERGEG advice in the context of the Third Energy Package


Dear Eddy,

In the context of the Commission's proposals for the internal markets for electricity and gas, where it was announced that more study is needed on transparency regarding derivatives and financial instruments, and advice will be requested from ERGEG and CESR, I enclose a joint mandate to CESR and ERGEG for advice.¹ In this context, the same letter will be addressed to John Mogg, Chairman of ERGEG.

We anticipate receiving the joint advice from CESR and ERGEG in two parts, by the end of May 2008 and by the end of December 2008.

Note also that another stream of work takes place in parallel: a joint mandate for advice to CESR and CEBS on the possible review of exemptions for some commodity firms from the Markets in Financial Instruments Directive and the Capital Adequacy Directive (Article 65(3) of the MiFID and Article 48(2) of the CAD).

Yours sincerely,


Jörgen HOLMQUIST

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¹ Pursuant to Articles 22f and 24f and Recitals 20 and 22 respectively in the two proposals for Directives amending Directive 2003/54/EC and Directive 2003/55/EC (The Third Energy Package)

Mandate

to the Committee of European Securities Regulators (CESR) and the Energy Regulators' Group for Electricity and Gas (ERGEG)

for technical advice pursuant to Articles 22f and 24f and Recitals 20 and 22 respectively in the two proposals for Directives amending Directive 2003/54/EC and Directive 2003/55/EC (The Third Energy Package)

This mandate requests joint advice from CESR and ERGEG on issues concerning record keeping and transparency of transactions in electricity and gas supply contracts and derivatives. The mandate is given in order to find out if additional measures are necessary with respect to transparency in energy trading, as announced by Commissioners Piebalgs and McCreevy following the adoption of the legislative proposals for the internal gas and electricity markets. It is also meant to provide to the Commission the adequate technical background to adopt the guidelines under Articles 22f/24f and Recitals 20 and 22 in the two proposals for Directives amending Directive 2003/54/EC and Directive 2003/55/EC.

This is a draft provisional mandate; it will possibly be completed by additional provisional mandates, depending on the development of the negotiation process before the Council and the European Parliament in relation to the proposed amendments to Directive 2003/54/EC and 2003/55/EC.

This mandate does not prejudice in any way the ongoing negotiations on any article in the Council and the European Parliament in the context of the co-decision procedure. A formal mandate may be sent to CESR and ERGEG once the amendments have been adopted in the co-decision procedure by the European Parliament and Council.

Advice is also sought on a possible clarification of the scope of the Market Abuse Directive in relation to trading in commodities and commodity derivatives.

The present mandate takes into full consideration the agreement on implementing the Lamfalussy recommendations reached with the European Parliament on 5 February 2002. In this agreement, the Commission committed itself to a number of important points, including full transparency. For this reason, this request for technical advice will be published on DG Internal Market's and DG Energy and Transport's web site and the European Parliament will be duly informed.

1. BACKGROUND AND LEGAL FRAMEWORK

The European Commission is to adopt guidelines pursuant to the following:

Article 22f of the Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/54/EC concerning common rules for the internal market in electricity relevantly states:

Article 22f

Record keeping

1. Member States shall require supply undertakings to keep at the disposal of the national regulatory authority, the national competition authority and the Commission, for at least five years, the relevant data relating to all transactions in electricity supply contracts and electricity derivatives with wholesale customers and transmission system operators.

2. The data shall include details on the characteristics of the relevant transactions such as duration, delivery and settlement rules, the quantity, the dates and times of execution and the transaction prices and means of identifying the wholesale customer concerned, as well as specified details of all unsettled electricity supply contracts and electricity derivatives.

3. The regulatory authority may decide to make available to market participants elements of this information provided that commercially sensitive information on individual market players or individual transactions is not released. This paragraph shall not apply to information about financial instruments which fall within the scope of Directive 2004/39/EC.

4. To ensure the uniform application of this Article, the Commission may adopt guidelines which define the methods and arrangements for record keeping as well as the form and content of the data that shall be kept. These measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 27b(3).

5. With respect to transactions in electricity derivatives of supply undertakings with wholesale customers and transmission system operators, this Article shall only apply once the Commission has adopted the guidelines referred to in paragraph 4.

6. The provisions of this Article shall not create additional obligations vis-à-vis the authorities mentioned in paragraph 1 for entities falling within the scope of Directive 2004/39/EC.

7. In case the authorities mentioned in paragraph 1 need access to data kept by entities falling within the scope of Directive 2004/39/EC, the authorities responsible under that Directive shall provide the authorities mentioned in paragraph 1 with the required data.

Recital 20 states:

20. Prior to adoption by the Commission of guidelines defining further the record keeping requirements, the Agency for the Cooperation of Energy Regulators and the Committee of European Securities Regulators (CESR) should cooperate to investigate and advise the Commission on the content of the guidelines. The Agency and the Committee should also cooperate to further investigate and advise on the question whether transactions in electricity supply contracts and electricity derivatives should be subject to pre and/or post-trade transparency requirements and if so what the content of those requirements should be.

The same provisions apply *mutatis mutandis* in Article 24f and Recital 22 in the proposal to amend Directive 2003/55/EC for gas.

The mandate also asks CESR and ERGEG for their views on possible clarifications to the scope of the Market Abuse Directive in the context of the review of that directive by the Commission to be completed in early 2009.

2. CONSULTATION AND SOURCES OF ADVICE

The Commission is to act 'on the basis of public consultation and in the light of discussions with competent authorities'. The Commission's White Paper on

Financial Services Policy 2005-2010 set out our commitment to open and transparent consultation:²

Open consultations (including with stakeholder groups) will continue to play a central role and will be required before any legislation is deemed necessary. The Commission will continue to publish responses received to its consultations, practical summaries and feedback statements.

In its advice CESR and ERGEG are asked to consider the advice on commodities markets and trading given separately by CESR and CEBS, the Committee of European Banking Supervisors, in the context of the Commission's ongoing review under Article 65(3) of Directive 2004/39/EC on Markets in Financial Instruments, and Article 48(2) and (3) of Directives 2006/49/EC on Capital Adequacy of Investment Firms and Credit Institutions. CESR and ERGEG are also asked to consider the views expressed during the Commission's Call for Evidence on commodities and the conclusions reached in the subsequent feedback statement.³

3. THE PRINCIPLES TO WHICH CESR AND ERGEG SHOULD HAVE REGARD

As regards its working approach, CESR and ERGEG are invited to take account of the following principles:

- The principles set out in the Lamfalussy Report and mentioned in the Stockholm Resolution of 23 March 2001;
- CESR and ERGEG should provide comprehensive advice on the matters described in Annex I;
- CESR and ERGEG should address to the Commission any questions which arise in the course of its work;
- CESR and ERGEG should also have close regard for the respective roles and functions of their members in various EU jurisdictions, as well as the relationship and levels of cooperation there are between energy and securities regulators in each. To the fullest, they should take this into account when issuing their advice.

4. QUESTIONS IN RELATION TO WHICH TECHNICAL ADVICE IS SOUGHT

Please consult **Annex I** for a list of questions in relation to which advice is sought.

5. DUE DATE

The advice from CESR and ERGEG is sought **by the end of May 2008** for questions in Sections C, E and F, and **by the end of December 2008** for questions in Sections D and G.

² *Op. cit.* at paragraph 2.1.

³ http://ec.europa.eu/internal_market/securities/docs/isd/derivatives_en.pdf

ANNEX I

A. INTRODUCTION

Well-functioning wholesale energy markets are an essential part of efficient energy markets. As competition develops trading becomes more and more important in the energy market. This means that financial and energy market regulation increasingly intertwine to achieve the goal of an internal energy market.

The Sector Inquiry as performed by DG Competition gave rise to concerns on the trust in and regulatory oversight over trading in energy markets. It concluded that "customers have little trust in the functioning of wholesale markets. They suspect market manipulation on the spot and forward markets by large generators to be the main reason for recent price increases. Concentration is a key factor in the proper analysis of the price developments. Other factors are the developments in fuel prices and the impact of the EU Emission Trading System.

Most wholesale markets have remained national in scope. The level of concentration in generation has remained high in most Member States giving generators scope for market power. The level of concentration in trading markets is less striking than in generation, particularly on forward markets where electricity can be traded several times before delivery. However, all spot and forward markets, even the most developed forward markets, remain dependent on the few players which enjoy a net excess of generation compared to their retail supplies.

Further, an analysis of who determines the clearing price at certain power exchanges indicates that there is scope to directly influence prices by excessive bidding prices for operators in Italy, Spain and Denmark. Possibilities to move prices might also exist in other markets.

In addition to excessive bidding, large operators can push up prices by withdrawing capacity. In that respect, it appears that load factors of generation units have increased over time in Germany and in France suggesting higher efficiency levels and a tighter supply/demand balance. However, significant generation capacity – most of it with low marginal costs – was retired in Germany despite slowly increasing demand. Also, certain plants with rather low marginal costs did not operate fully at all times."

DG Competition then carried out a detailed study of the functioning of the electricity markets in six Member States and the final report was published in April. The first part of the study looks at how many operators are effectively competing on the market on an hourly basis. The second part of the study reports on the difference between what the price of the market was in the period and what it would have been if the markets in DE, ES, NL, and UK had been perfectly competitive. This difference, referred to in the study as the "mark-up", was calculated by stimulating a perfectly competitive market for each hour of the period. The study shows that the mark ups vary over time and between Member States. Mark-ups are generally higher in DE and ES, and lower in GB and NL. The mark-up identified in the study is not the same as the profit of each company.

The third part of the study looks at the relationship between the number of operators competing at a given time and the "mark-ups". This analysis shows that there is a statistically relevant correlation between the numbers of generators who have spare

capacity and the mark-ups in each hour: in other words, the more needed generators are, the higher the mark-ups in the market become.

More information on the sector inquiry and the electricity study can be found via <http://ec.europa.eu/comm/competition/sectors/energy/inquiry/index.html>.

As prices in bilateral contracts with end-customers are increasingly linked to wholesale market prices either directly or indirectly, there will be a growing incentive for the large energy undertakings to use their market power to influence wholesale market prices. The Commission therefore proposed strengthening the transparency requirements on physical information in its legislative proposals of 19 September 2007. It is currently considering the need for additional transparency requirements on trading activities. For example, given the different degrees of transparency between transactions on trading fora, including brokers' screens, and OTC transactions, there is a risk that high priced deals could be directed through transparent fora, thus raising the official wholesale price and having a knock-on effect on end-users.

Commissioners Piebalgs and McCreevy have stated, at the time of the adoption of the legislative proposals for the internal energy market, that transparency of trading in energy markets is a topic that needs further study to see if additional measures are necessary. They have agreed to cooperate with ERGEG and CESR on this topic, and to reach a conclusion by May 2008. Therefore the Commission services have the following mandate for advice to ERGEG and CESR.

B. DEFINITIONS

Market failure: any significant sub-optimality in market functioning. For example, where applicable, evidence of this could take the form of a wide dispersion of market prices, persistent concentrated market shares, persistent excess profits, a high level of investor complaints, significant information asymmetries leading to misallocation of resources, excessive risk-taking leading to a potentially high level of systemic risk, etc.

Regulatory failure: a regulatory state of affairs (including at European or at Member State level) which has the effect of:

- (i) creating significant competitive distortions; or
- (ii) significantly impairing the free movement of services between Member States; or
- (iii) encouraging market participants to engage in a significant degree of regulatory arbitrage.

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 within the meaning of the Directive 2003/55/EC (Art 2.7 and 2.8)?
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.
 3. What (regulatory) authority oversees trading activities in energy markets in EU Member States?

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))?
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 the 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 extent 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 transaction record format based on the content and data to be provided as per Table 1 of Annex I of Regulation EC 1287/2006.

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?
7. How would securities regulators most efficiently provide information to energy regulators pursuant to paragraph 7 of Article 22f/24f?
8. Which securities regulator would most efficiently be responsible for such provision in the case of investment firms with more than one branch?
9. Would it be feasible and efficient to employ the Transaction Reporting Exchange Mechanism (TREM) or a similar electronic system to exchange this data?
10. Is there a case for data to be forwarded from energy regulators to securities regulators on an automatic basis? If so, what data?

E. TRANSPARENCY

In answering the following, CESR and ERGEG are invited, where applicable, to build on the answers provided in CESR's initial advice to the Commission on commodity and exotic derivatives and related business (CESR/07-429, July 2007).

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?
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?
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?
14. Is there a difference in transparency requirements for spot trading compared to future and forward trading? If so, why?
15. Is there a difference in transparency requirements for exchange trading compared to OTC trading? If so, why?
16. What information, other than required by law or regulation, is made public by energy traders, brokers, information services or exchanges?
17. Is access to information on traded volumes and prices equal for all parties active in that market?
18. If not, is unequal access to or general lack of information on trading causing distortion of competition?
19. In light of the findings in the Commission Sector Inquiry on energy and the subsequent study of the electricity wholesale markets, please consider:
 - a) whether, pending the outcome of the legislative process in respect of the proposed Directives amending Directives 2003/54/EC and 2003/55/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;
 - b) whether such transparency arrangements could be expected to effectively mitigate the concerns identified in the Sector Inquiry above;
 - c) whether uniform EU-wide pre- and post-trade transparency could have other benefits;
 - 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)?

F. MARKET ABUSE

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

G. GENERAL

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

Impact analysis

CESR and ERGEG should analyse the options that they identify in an initial screening for further study in terms of likely impacts (costs and benefits) on market quality, and on market users including intermediaries and consumers/suppliers of commodities.

To the extent possible, in developing their advice CESR and ERGEG should apply the framework for impact analysis recently drawn up by the 3 Lamfalussy Level 3 Committees.

Wherever possible, quantitative and statistical data and economic analysis should be provided to justify conclusions.