



Energy vs. financial market regulation

The new European rules to improve integrity and stability
of (energy) commodity markets:

Great solution or big illusion?

Johannes Kindler

Vice-President Bundesnetzagentur, ERGEG Vice-President

8th US-EU Energy Regulators Roundtable

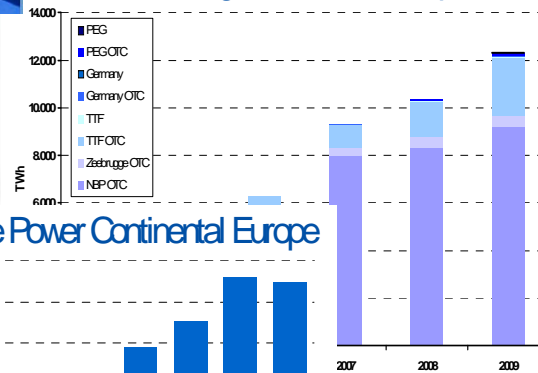
Berlin, 26 – 27 October 2010

- **Trading with electricity and gas:**
A strategic pillar of energy supply in Europe
 - **Hypes** at the commodity markets
 - **Challenges** for Energy Market integrity
 - **Regulators advice**
 - One Commission, **competing approaches**
 - Merge the best ideas and...
- ...what can we learn from the U.S.?**

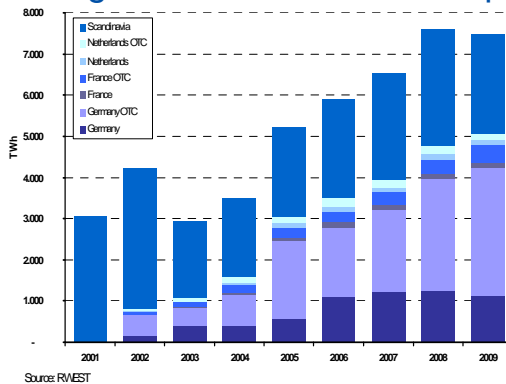


TRADING =
Strategic pillar of
energy supply on
the way to the
European Single
Market

Trading Volume Gas Europe



Trading Volume Power Continental Europe



- **Important tool**

- for utilities and the industry to hedge risks in more and more volatile markets
- to integrate renewables in classical systems of supply and to keep them affordable

- **Our Vision:**

Free Trading and a level playing field from Palermo to Hammerfest

The agricultural hype: Do fundamentals drive the price?

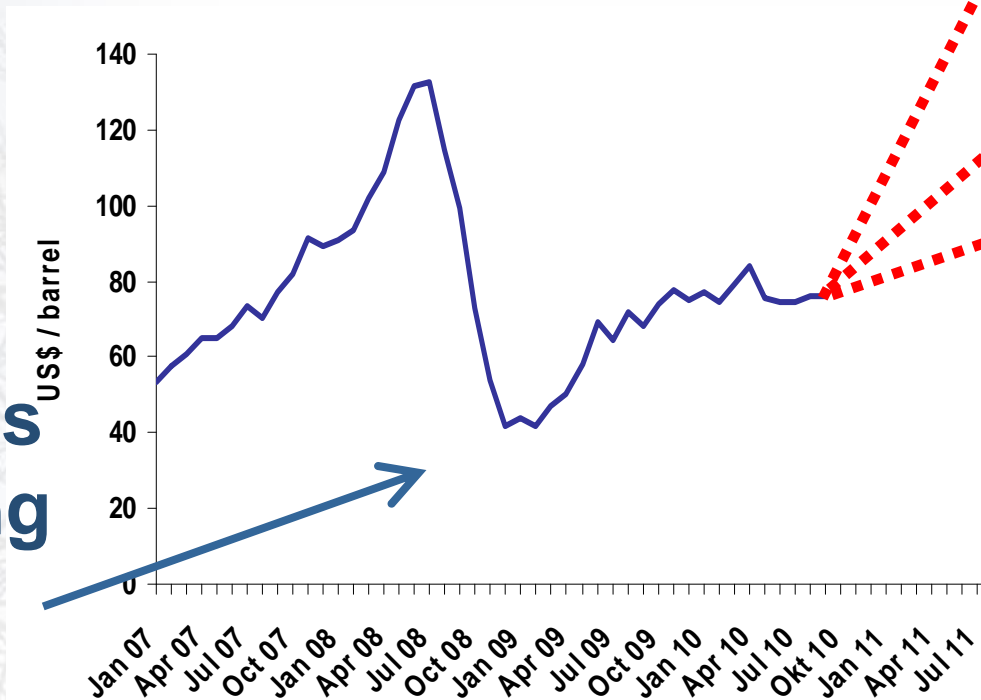
SKYROCKETING WHEAT, RICE AND CORN PRICES

„COTTON PRICES HITTING A 15-YEAR HIGH“

**„ARABICA COFFEE RISING
TO A 13-YEAR HIGH IN NEW YORK“**

Source: FT.COM, 7th September 2010

Development of crude oil prices from January 2007 until Sep 2010



Since Jan 09 oil prices are rising again

Are we facing the next oil price hype?

Source: International Monetary Fund (IMF)

Challenges for market integrity

Sharon Bowles, MEP (liberal !):

“Markets are mad, bad and dangerous!”

Is she right?

Is energy trading sufficiently protected with regard to market abuse, excessive price volatility and speculation?

Note: “Mad” markets are not automatically “bad” ones, unless they are distorted by market abuse!!!

At the end of 2007, European Commission mandated an expert group of energy and financial regulators

Question:



Does the current regulation on financial markets (MAD, MiFID) provide reasonable protection against market abuse (insider dealing and market manipulation)?

Answer:



“The doors are wide open to any kind of market abuse”

What the experts found out:

Electricity and gas trading is **NOT** sufficiently protected against market abuse.

- Increase of energy trading creates **massive** "new" risks for market integrity
(market manipulation, insider trading, VAT fraud)
- **Differences** between national regimes result in (unjustified) barriers for **wholesale trader to market entry** and thus present an **obstacle** on the way towards a true pan-European energy market



What did ERGEG/CESR recommend?

A sector-specific, tailor-made anti market abuse regime (not only **gas** and **electricity**, but also **emission allowances**)

- Transparency of fundamental data (price sensitive information, e.g. power plant outages)
- Transparency of trading data (anonymous publication of transactions close to real-time)
- Efficient reporting
- Efficient supervision → **who?** and **how?**



A sector-specific regime is needed for electricity and gas trading,

taking account of CO₂-trading,

some also call for inclusion of coal and oil markets.



...but competing approaches:

Financial legislation:

- Review of Markets in **Financial Instruments** Directive (MiFID)
- Review of **Market Abuse** Directive (MAD)
- **Special safeguards for OTC derivatives**

Sector-specific legislation (energy, CO₂):

- **3rd Energy Package**
- Proposal for an **transparency and market integrity** regime
- Draft Regulation on **European Emissions Trading Scheme**

Draft Regulation European Emissions Trading Scheme

(Commissioner *Hedegaard*, Climate)



- **Scope and impact**

- provisions on market abuse regime for ETS (insider dealing and market abuse)
- Supervision by competent national authorities

- **Status:** Commission Draft forwarded to European Parliament and Council (July 2010), Investigations on sufficiency of protection

Proposal for a sector-specific transparency and market integrity regime

(Commissioner **Oettinger**, Energy)

- **Scope and impact**

- Electricity and gas markets
- Transparency of fundamental data
- Reporting of transactional data
- Definition of insider information and market manipulation
- Monitoring by national energy regulators (dominant role of ACER)
- Enforcement by energy regulators (regarding spot/physical markets) and financial regulators (regarding financial instruments)



- **Status:** Proposal due in autumn 2010

European Markets Infrastructure Regulation

(Commissioner *Barnier*, Internal Markets)

- **Scope and impact**

- Regulation on OTC derivatives, central counterparties and trade repositories
- Mandatory trade repositories and mandatory clearing for OTC derivatives
- Mitigation for non-financial firms who use OTC derivatives for hedging purposes

- **Status:**

- Proposal for regulation was published on 15 September

Review of Markets in Financial Instruments Directive (a “*derivative*” of the G20 proposals)

- **Scope and Impact**
 - **MiFID** is dedicated to protect **investors** and is targeted to monitor **financial institutions**;
 - **Amendment** of the **scope** of **MiFID** to cover most of the **derivatives** market (position limits, improve transactional transparency, supervisory body → European Securities and Markets Authority, ESMA)
 - Barnier fosters an extension of **MiFID** to cover **larger** parts of the commodity market. Barnier: *“This is a key issue.”*
- **Status**
 - Legislative proposals in spring 2011

Review of the Market Abuse directive

- **Scope and impact**
 - **Market manipulation** and **insider trading** of financial instruments
 - Review should fill the **gaps** in regulation of certain instruments and markets
 - Supervisory body: ESMA
(European Securities and Markets Authority)
- **Status:**
 - Legislative proposals in spring 2011

- Even “honest” commodity trading contains considerable risks, especially for SMEs.
- Commissioner Barnier (like the G 20) has “forgotten” one crucial element:

Transparency of fundamental data

Merge the best ideas with regard to:

- **transparency;**
- **efficient reporting; and**
- **supervision.**

Sound compromise between energy and financial market sides needed

“Energy side” (NRAs, Commissioner Oettinger) has taken account of the US experiences (FERC, CFTC)

What we still need to „sell“ ...

What we need to sell:

(why not to the entire commodity market, where appropriate?):

The principle of publication of fundamental data.

Better knowledge of the current market situation

- keeps traders from building up dangerous positions and exaggerated risk taking
- is important for the **reduction of systemic risks**
- is the best way to avoid “**speculative hypes**” and contributes to **fair prices** charged to **end customers**
- easier access to information **levels the playing field for small traders** to balance structural disadvantages reg. resources / IT

- Responsibles in the gas and power sector have started to **pay attention to Fundamental Data Transparency**
(3rd Energy Package, Draft Comitology Guidelines on Fundamental Data Transparency)
- Furthermore, transparency about the fundamentals is **crucial for all commodities** as the knowledge of available quantities is price relevant, i.e. **agricultural products, CO2 emissions and metals**



Thanks for your attention!