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# **Energy vs. financial market regulation**

**The new European rules to improve integrity  
and stability of (energy) commodity markets:  
Great solution or big illusion?**

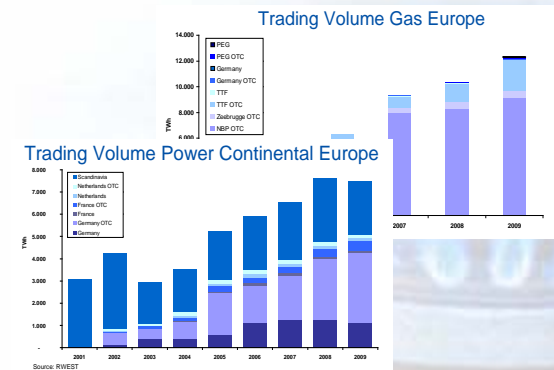
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**Session IV: Transparency  
8th US-EU Energy Regulators Roundtable  
Berlin, 26 – 27 October 2010**

- 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
- Current initiatives
- Merge the best ideas and  
**what can we learn from the U.S.?**

# Trading with Electricity and Gas: Strategic Pillar of energy supply

- On the way to the **European Single Market trading with electricity and gas** has become a **strategic pillar** of energy supply:
- **Important tool**
  - for utilities and the industry to control and 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“**

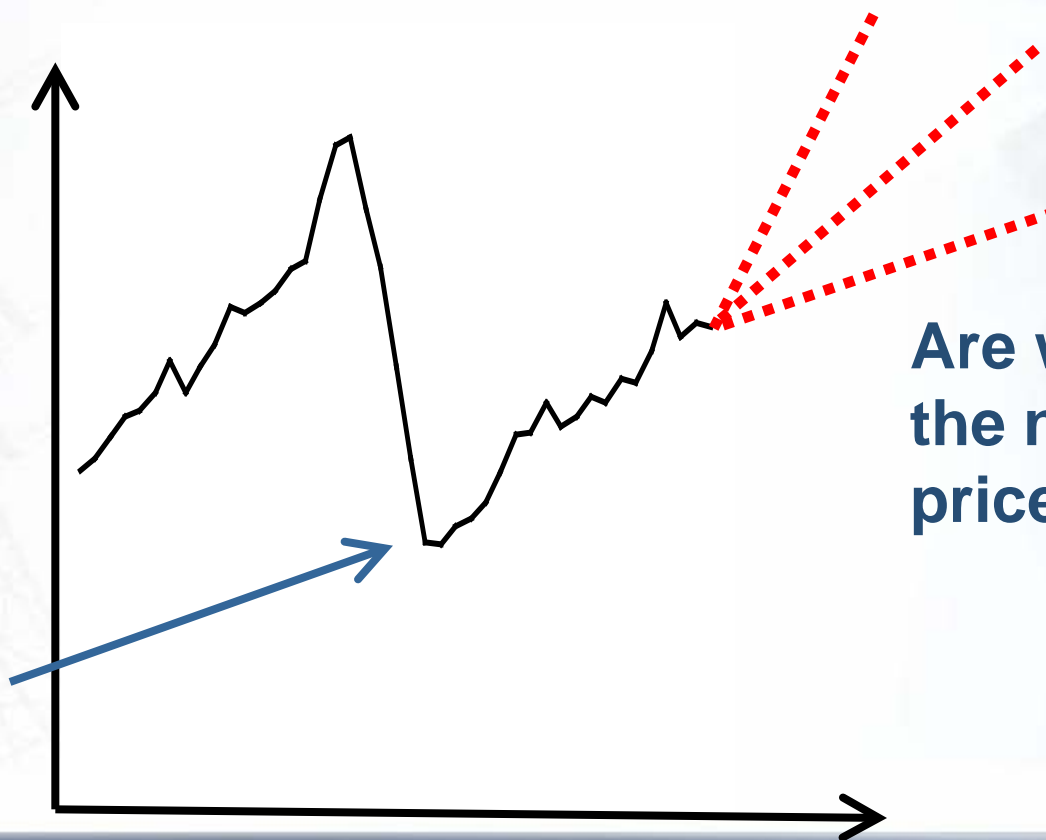
**„ARABICA COFFEE RISING TO A 13-YEAR HIGH IN NEW YORK“**

Source: FT.COM, 7th September 2010



# Global economy still down/recovering. Oil prices high.

## Development of crude oil prices from January 2007 until July 2010



Since January 2009 oil prices are rising again

Are we facing the next oil price hype?

# 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!!!**

# Challenges for market integrity

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 abuse, 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.**

## ...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, CO<sub>2</sub>):

- **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 European 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 energy regulators (dominating 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 derivative
  - Mitigation for non-financial firms who use OTC derivatives for hedging purposes
- **Status:**
  - Proposal for regulation has been published on 15<sup>th</sup> Sept.

## Review of Markets in Financial Instruments Directive

- **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**

- Public Hearing took place on 21<sup>st</sup> Sept 2010
- 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
- **Status:**
  - Legislative proposals in spring 2011



# Risks and Shortcomings

- 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**

## Our advice: Merge the best ideas! Properly consider fundamental data transparency!

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

# Conclusions

- Responsibles in the gas + power sector have started to **pay attention to Fundamental Data** Transparency (3rd Energy Package, Draft Comitology Guidelines on Fundamental Data Transparency)
- **Energy** regulators support the **sector-specific** approach of Oettinger (REMIT) and see the need for a prominent role of **energy** regulators!
- 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!**