



EFET FACT SHEET: UNINTENDED CONSEQUENCES

- I. EFET and its members believe that **efficient, integrated, transparent and liquid energy markets are vital** to ensuring a secure, sustainable and affordable energy supply to European consumers. Effective competition and market accessibility at the wholesale level facilitate reliable price formation and risk hedging by suppliers and larger users of energy. In turn they allow choice for smaller consumers and underpin competition in retail energy markets.
- II. ESMA's draft Regulatory Technical Standards (RTS) could have, unintended, consequences for many energy and real economy companies **which will become subject to requirements applicable to investment banks**. If enacted in their proposed form, the rules would see many companies involved in energy trading, including small and medium-sized utilities, either being treated as if they were banks, subject to the higher costs and onerous capital requirements, or forced to reduce substantially their activity in the market. This could result in less secure, affordable and sustainable energy and ultimately harms Europe's economy and its competitiveness.

Impacts on the energy sector

- III. The main goals of the Energy Union are to increase competition, to drive down energy costs for citizens and businesses, to boost growth and to complete the internal energy market. The immediate impact of these new rules on energy markets will be on market liquidity due to the anticipated reduction of activity of market participants in traded markets. Liquid wholesale energy markets are **indispensable** to achieve the goals of the Energy Union. **Less liquid markets mean less efficient, competitive and secure markets**. Energy regulators themselves have identified liquidity in wholesale markets as a key factor for a healthy market and competitive prices for energy consumers.
 - a. Reduced liquidity means that it will become more difficult to assess & manage risk and to obtain funding. This will increase prices and the cost of doing business for the industry by **billions of Euros** which will inevitably be passed on to the European economy through producers and consumers.
 - b. Reduced liquidity also means that the spread between the buy and sell prices increases when there are fewer market participants and fewer transactions: the higher the spread the higher the costs to the real



economy. Every 10% increase in the spread will cost the European economy **€270m on an annual basis**. And it is not unlikely that the spread could double – which would cost the economy **€2.7bn**.

- c. The impact of reduced market liquidity on hedging costs could translate into **€11.7bn** in additional costs on an annual basis to industry due to the longer time needed to hedge consumption or production of energy.
 - d. Less liquidity means that fewer products will be available in the market to hedge production and consumption. For example, the reduced availability of storage products alone will cost nearly **€1bn** every year to the EU economy.
 - e. As affected companies will have to **reallocate capital within their businesses to comply with these requirements**, liquidity would be further restricted. This would unnecessarily constrain the efficiency of wholesale markets, limit competition, drive up prices for consumers and industry and fail to attract energy sources from around the world.
 - f. For a large European energy trading company, the estimated capital and liquidity required to support its business as a regulated entity under MiFID II can vary between **€3-6bn**.
 - g. Additional capital and liquidity cannot always be possible because of cash liquidity constraints. In this case, reduction in trading activity will take place.
 - h. Where it is possible to reallocate capital, this liquidity becomes **“trapped”**. The direct cost for 10 companies subject to such requirements is on **average €1.7bn on an annual basis**.
 - i. Further costs for energy companies – and therefore the European economy – are expected in relation to central clearing, collateral requirements, worsening of credit ratings, and higher operational costs and investments in IT
- IV. Small and medium-sized commodity (trading) companies and the industrial companies that run ancillary trading operations may be forced to **exit the market** due to prohibitive capital and obligations to provide liquid collateral for all derivatives.



Impacts on energy consumers

- V. The knock-on effect of reduced liquidity on consumer energy prices would be substantial:
- a. EU electricity consumers would pay about **€5bn¹** every year for every percentage increase in final prices resulting from lower competition and efficiency.
 - b. EU gas consumers would pay about **€1.8bn²** every year for every percentage increase in final prices resulting from lower competition and efficiency.
 - c. Every additional hour that supply is expected not to meet demand by causing a blackout, could cost European consumers and the European economy up to **€12bn³** (*i.e.*, **one hour of blackout per ten year would still cost the EU economy on average €1.2bn per year**).

Additional impacts

- VI. *Adopting proposals that would inflict significant additional costs on the European economy and harm the EU's competitiveness would be in stark contrast with some of the key policy objectives of the Commission. They would come in addition to another recent ESMA proposal – to remove the hedge exclusion under the EMIR regulation - that would cost European business **some €200bn** according to recent research from the Deutsches Aktieninstitut.*
- VII. The EU's Better Regulation Agenda should ensure that any new proposals “meet policy goals at minimum cost and deliver maximum benefits to citizens, businesses and workers while avoiding all unnecessary regulatory burdens [...] allowing the EU to ensure its competitiveness in the global economy”. The Energy Union should drive down energy costs, complete the internal energy market and reduce greenhouse gas emissions. It is difficult to see how the current ESMA proposals would contribute to these important EU policy goals.

¹ Source: Eurostat. The estimate is based on annual EU28 generation of 3,100 TWh in 2012 and the average of average EU28 household and industrial prices in the first half of 2013.

² Source: Eurostat (prices) and Eurogas (volumes) combined to estimate annual EU28 spend on gas.

³ Source: Based on Entso-E (*i.e.* not EU-28) peak demand of 530 GW in January 2013, a value of lost load of £17,000/MWh at €1.35/£ (as calculated in discussions for the UK capacity market – page 8 “Annex C: Reliability Standard Methodology”, July 2013 – UK Department of Energy & Climate Change).