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ISDA-EFET-FOA response to consultation paper on the

CESR and ERGEG draft advice to the European Commission in the context of the Third Energy Package (record-keeping, transparency and exchange of information)

25 November 2008

Introduction

This paper is in response to the CESR/ERGEG draft advice to the European Commission, (published on 24 October 2008) on record-keeping, transparency and exchange of information, in the context of the Third Energy Package.

The three associations whose views are represented in this paper represent a large portion of the participants in wholesale electricity and gas markets. These organizations have been cooperating as part of the 'Commodity Derivatives Working Group' (CDWG), focusing on the review of commodities business mandated under MIFID and the CRD, as well as the EU consultations taking place concerning regulation of wholesale electricity and gas markets under the Third Energy Package.

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,

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commodity trade houses, power and energy companies, exchanges and clearing houses, as well as a number of firms and organizations supplying services into the futures and options sector.

EFET works to promote the development of a sustainable and liquid European wholesale market in electricity and gas, as well as in related physical commodities and derivative contracts. EFET is complementary to existing industry organizations in Europe as it is solely dedicated to energy trading issues, and lists over 100 firms as members.

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Executive Summary

The CDWG would like to thank CESR and ERGEG for addressing record-keeping, transparency and information exchange in relation to wholesale electricity and gas markets in this draft advice, and welcomes the opportunity to comment in this context.

The CDWG position on record-keeping, transparency and information exchange between regulators can be summarized as follows:

Record-keeping

We believe the distinction between record-keeping and transaction reporting requirements should be clear. There should be no suggestion that records retained should facilitate frequent, systematic reporting of transactions to regulators. Costs associated with record-keeping would increase dramtically were this the case.

Records containing relevant data sufficient to enable regulators to monitor compliance with relevant regulatory requirements should be made available to regulators upon request, or as part of any investigations by regulators.

Members of the CDWG associations have reservations about certain contents of the records as set out in the draft advice, most notably (but not exclusively) regarding counterparty identification. CESR may recall the issues encountered in relation to ISINs at the time of MIFID. This issue remains of major concern.

We have no objection to a requirement for retention by electronic means. However we believe that each supply undertaking should be able to decide on the system they use and the precise form and detail of the records they provide, provided they meet the minimum data requirements specified by regulators, and that the records are maintained and provided to regulators upon request in a manner that facilitates their understanding of these records.

Transparency

The CDWG supports the application of aggregated post-trade transparency requirements to (power and gas) exchanges, brokers and MTFs as the most efficient and effective way of ensuring this infromation is released to the market.

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These requirements should apply to the types of instruments generally transacted on these systems i.e. liquid physical and derivative contracts subject to a large degree of standardization. Such instruments would provide the clearest and most useful pricing information to the market.

The CDWG associations underline that this information should be published by exchanges, brokers and MTFs, and not by regulators. CESR and ERGEG will be aware that generally, market participants do not see a significant additional need for publication of post-trade information – but there may be a case if it is a common, proprtionate, EU approach, building on and enhancing the systems these operators already have in place, which are widely utilized by the market.

The CDWG would be happy to work with regulators to facilitate greater post-trade transparency in this respect - including liasing with brokers and operators of exchanges and MTFs to discuss how best to ensure information is made available/accessible to all market participants.

Although not the subject of this consultation, the CDWG has stated its support, in several previous submissions to regulators, for heightened transparency around use of essential infrastructure in physical markets, such as electricity generation and transmission, gas storage and gas transport.

The CDWG member associations feel strongly that there is no justification for any pre- and pos-trade transparency requirements falling directly on market participants. These firms feel that such requirements could seriously impede the development of electricity and gas markets (gas markets in particular, are at a delicate stage in their development, and such transparency requirements would be particularly ill-suited to these markets, discouraging potential new entrants and reversing what development there has been). Participants in these markets urge CESR and ERGEG to take a proportionate approach, in the absence of any clear regulatory or market failure regarding transparency in this area.

Publication of data on bilateral, bespoke transactions in physical and derivative contracts would cause problems in relation to the commercial sensitivities of this information, but would also add little to market participants' understanding of market developments (because of the bespoke nature of these contracts, where the price is often only one of a number of important contractual specifications). There would also be considerable cost to market participants, on whom the burden of such publication would (presumably) fall (as such transactions are not cleared or transacted through exchanges, brokers or MTFs). Regulators of course would have access to such information on request as part of companies' record keeping obligations.

Exchange of Information

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In general, the CDWG views the modalities of exchange of information between regulators as a matter for them, presuming the ability of market participants to engage in business is not undermined by any consequent compliance burdens falling on market participants.

We do believe, however, that all information provided to energy and financial regulators should be provided on a home state basis (i.e. thus, investment firms and their branches should provide information to their home state (of the 'parent' investment firm) energy and financial regulators, and it should be up to these regulators to exchange information with their counterparts in other States as they see fit.

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I Record-keeping

1. Do you agree with the abovementioned analysis of the purpose of record-keeping obligations for supply undertakings in the Third Energy Package? If not please explain your reasons.

We agree with much of the analysis on the purpose of record-keeping obligations, contained in paragraphs 61-68.

However the CDWG believes that it should be clear that a record-keeping requirement should not be confused with a transaction reporting requirement. In this context we would like to particularly underline that we welcome the consultation paper's recognition, in the Executive Summary, that 'record-keeping has to be clearly distinguished from transaction reporting or any other form of transmission of information included in the records of supervised firms to competent authorities' and that 'regarding transaction reporting….the Third Energy Package does not include any requirements.'

In our view, the analysis contained in paragraphs 61 to 68 should be more clearly defined. We agree that regulators should be given the legal basis to demand these records in order to investigate compliance with trading and contracting rules or the conduct of market participants in competition cases. However regulators should only have the legal basis to request records on a case-by-case basis. Any obligation requiring compulsory, periodic transmission of trade data by market participants to regulators (and not on request, on a case-by-case basis, for the kinds of reasons outlined earlier in this paragraph) would amount to transaction reporting, which would be prohibitively expensive.

2. Taking into account the potential purposes of record-keeping requirements under the Third Energy Package, do you agree with the above mentioned minimum contents for records to be kept by supply undertakings?

3. If not, please specify the items not necessary or additional items necessary with respective reasons.

In previous submissions to CESR and ERGEG, ISDA, FOA and EFET commodity firms have expressed a willingness to retain records for 5 years, though they have warned against an overly prescriptive approach. We maintain some concerns in this regard.

Concerning the characteristics of the transactions that would need to be retained in the records, as set out by CESR and ERGEG, we make the following observations:

- **Counterparty identification**: This suggestion provokes serious concerns. No such counterparty IDs are currently available and current IT systems don't have the capacity

to deal with these. CESR may recall the major reservations expressed by firms with regard to the complexity and cost associated with the MIFID ISINs proposals (which aimed to ease standardisation and transmission of data between regulators). At that time, regulators decided not to proceed with the ISINs proposals because of these concerns, which remain relevant in this context.

- Regarding the contents of the records currently maintained under MIFID record-keeping requirements (paragraph 81), or additional items listed as desirable for retention purposes in the paper, a number of these items are irrelevant, add little value, or could create confusion in terms of regulatory understanding, with regard to supply undertakings active in electricity and gas markets

    - '**The executor or person responsible for execution of a trade'** – of little relevance for supply undertakings;

    - The **'quantity notation (number of underlying assets)**' which should be omitted, as 'quantity notation' is the same as 'quantity' in electricity and gas markets (another item in the MIFID record-keeping list). Some clarity is needed as to what exactly 'quantity' refers to in some contracts, as the meaning of 'volumes' can vary according to effects/changes in relation to optional rights in the contract.

    - **'Indexation formula'**, one of the items listed as needed in addition to items listed in those required under MIFID, but which add little to understanding of price formation, and rather, adds considerably to complexity in this context.

    - '**Load type'** definition may vary from Member State to Member State and is also power-focused.

    - **Pricing information** would be useful in relation to standard contracts, but calculation of the value of the contract could be very complex and costly in relation to more complex transactions involving non-fixed indices or quantities.

4. Do you see practical difficulties if investment firms not covered by the scope of the Third Energy Package are not obliged to keep the additional contents of transactions in financial instruments in their records?

We note that investment firms would be faced with costs associated with upgrading existing requirements for keeping records of transactions in MIFID financial instruments (with electricity and gas as the underlying), as well as new requirements for spot and other physical

transactions. We don't believe that any such requirements should be imposed on these firms without careful consideration of the financial impact of this extra burden.

5. ***Which option do you think is most efficient for the purposes of the Third Energy Package?***

6. ***If an electronic format will be required, is it sufficient to leave the design of the specific kind of "database" used to retain the minimum content of the records to each supply undertaking?***

7. ***If possible, please provide indications of the specific costs involved with different electronic formats conceivable (e.g. from Excel sheet to more sophisticated software).***

It is not possible, within the timeframe laid down for this consultation, to get a clear idea of the costs associated with these obligations at a broad industry level.

An obligation to keep records at the disposal of regulators should they (on occasion) suspect wrongdoing, would be a lot less costly than a de facto frequent transaction reporting requirement, designed to aid regulators in publishing market data for transparency purposes.

We believe it is likely that market participants will keep records in an electronic format, and as such, we have no objection to a requirement for retention by electronic means. However we propose that each supply undertaking should be able to decide on the system they use and the precise form and details of the records they provide, provided they meet the minimum data requirement, and that the records are maintained and communicated (on request) to regulators according to a design that aids straightforward understanding of these records on the part of the regulators (we would support a principles-based approach in this regard).

II Transparency

Introduction

The signatory associations believe that there may be value in regulators requiring the publication of post-trade, aggregated transaction data on commodity transactions conducted or cleared at (power and gas) exchanges, MTFs, or by brokers as the most efficient and effective way of ensuring this information is made available to all market participants.

Market participants do not believe that it should be the role of regulators to provide such data to the marketplace.

The transparency solution we support would have a number of advantages in comparison with the various options proposed by CESR and ERGEG in this consultation paper.

In comparison with option M1 (status quo), this solution would ensure equal access to this data for all market participants, and a single, harmonized approach to post-trade data transparency throughout the EU.

In comparison with option M2 (dissemination based on the assessment of the sufficiency of existing information), this solution would ensure a common EU approach to wholesale market transparency, ensuring a level playing field in regulatory and competiveness terms in Europe.

The approach we propose may be seen as a variation on option M3 (mandatory dissemination).

As mentioned, we believe that the scope of the information to be published should include data on standardized (e.g. in relation to maturities) physical and derivative contracts of the type generally transacted at these infrastructures. These instruments make up the most liquid markets, giving the clearest and most accurate price signals. Publication of data on bilateral, bespoke transactions in physical and derivative contracts would cause problems in relation to the commercial sensitivities of this information, but would also add little to market participants' understanding of market developments (because of the bespoke nature of these contracts, where price is often only one of a number of important contractual specifications), at considerable cost to market participants (should they be required to publish this data, given that these transactions are not typically transacted at central infrastructures of the type refered to above).

It should be mentioned that gas market participants are particularly concerned that the direct imposition on firms of additional transparency requirement in this area would have a particularly detrimental impact at this stage in the European gas market's development. These participants point out that day-ahead and intra-day markets in gas in Europe are only now developing adequate levels of liquidity and participation, and that liquid gas derivative markets are only apparent in the UK (where a system of post-trade transparency focusing of exchanges, MTFs and brokers is in use).

Gas market participants further point out that should such a more burdensome form of transparency requirement be imposed, this requirement would not apply to pipeline gas supplied from outside the EU, nor gas transacted from the global LNG market – handicapping EU-based market participants.

The CDWG would be happy to work with regulators to facilitate greater post-trade transparency - including liasing with brokers and operators of exchanges and MTFs to discuss how best to ensure information is made available/accessible to all market participants.

8. Do you see a need for a harmonised publication of aggregate market data on an EU/EEA level? Please provide your arguments for/against such publication.

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As mentioned, we support a variation on option M3, focusing on publication of post-trade, aggregated transaction data on commodity transactions conducted or cleared at exchanges, MTFs, or by brokers.

Apart from the advantages described above, such data is already available to many market participants from these sources (as well as from other commercial data providers such as Platts, Bloomberg), on, a post-trade basis, on commercial grounds. Along the lines of previous ERGEG recommendations, the regulatory obligation on the operators of these platforms would be to make accessible to the market certain available post-trade information on transactions, including 'best bid/best offer', 'market depth', and 'trades done'.

The advantages of harmonization are clear. Aggregation of data would address concerns about the potential commercial sensitivities of trade data.

9. Do you consider that this publication should cover all instruments, including those covered by MiFID?

If aggregated transparency of MIFID electricity and gas derivatives were to be mandated, this aggregation should be based on data available from exchanges (electricity and gas derivatives traded therein are already traded in conditions of high transparency), brokers and MTFs, limiting the new compliance burden on participants in these markets.

We believe that at an aggregated level, transparency requirements covering OTC direct bilateral trades, both physical and derivative, would be of limited value, given the bespoke nature of these trades, in which, for example, price is often only one of a number if important contractual conditions. We strongly oppose proposals for pre- or post-trade transparency applying to wholesale electricity and gas market participants in relation to such trades. Such steps would create problems in terms of the commercial sensitivity of the data, have been clearly opposed by market participants in previous submissions to regulators, would be costly to comply with, and would do little to aid the understanding of the market, nor of regulators. We underline, however, that market participants should retain records of such transactions, and that regulators should have the right to receive such data from market participants, on a case-by-case basis, when conducting an investigation.

Where regulators seek information on individual bilateral contracts, they should have the power to request records retained, and release information to the market as appropriate, while ensuring commercial confidentiality is maintained.

We note that paragraph 3 of Articles 22f/24f of the Third Energy Package recognizes the potential for overlapping regulation for investment firms already regulated for transparency purposes under MIFID, and we urge for further careful consideration in this context.

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10. Among the information proposed to be published, which ones are the most useful and why? Which one(s) should be published?

The signatory associations maintain that, from the point of view of the wholesale market participants it would be most appropriate to focus transparency requirements in electricity and gas markets, on exchanges, brokers and MTFs etc, on the standardized, liquid instruments transacted and cleared at these venues (this view held by market participants has been recognized by CESR and ERGEG). We believe that aggregated post-trade transparency would be deemed as of most value by the market.

This data should focus on information such as volumes, number of deals, average prices for products i.e. the type of information that would inform assessments around liquidity and price formation.

We stress that this data should be published by these infrastructures/platforms and not by regulators.

11. Are the two levels of aggregation on products proposed appropriate and useful?

12. Among the options proposed for the level of aggregation during the period covered, which ones are the most useful and why? Which one should be chosen?

The signatory associations have a preference for publication of aggregated data on contracts with standardized maturities as referred to in the second bullet of paragraph 174, i.e. contracts traded on RMs, MTFs, spot exchanges, brokers' platforms, and direct bilaterally, for standardized maturities.

Extension of these requirements to the more bespoke end of the direct bilateral market, featuring, for example, different types of maturity, would be of limited value to the rest of the market, and would come at a proportionately higher cost to firms (the lack of standardization therein would make compliance more onerous). As explained above, this should not apply to bespoke bilateral transactions.

13. Among the options proposed for the frequency of publication, which ones are the most useful and why? Which one should be chosen?

We believe that, based on the approach we support (focusing on post-trade, aggregated data from exchanges, brokers and MTFs), daily publication of data may be possible (many of these operators already provide such a service), subject to cost-benefit analysis, for many markets. We would suggest, however, that regulators should consider prevailing market practice in different markets, in assessing this problem, as well as levels of development and liquidity.

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14. Do you consider that, in practice, as far as transactions in energy related products are concerned, distortion of competition may result from unequal access to or lack of transaction information? Please provide evidence for your agreement or disagreement.

We are aware of no evidence that unequal access to or lack of transaction information distorts competition.

The key sources of information on transaction data i.e. broker and MTF data and other commercial sources (Platts, Bloomberg, Reuters etc) are available to market participants subject to commercial agreement, on generally equal terms and tailored to their individual needs. However potential market entrants may be encouraged by the public availability of such data.

The signatory associations do not suggest that European energy markets are optimally competitive. We believe that the key priorities for action in this regard were highlighted in the in the DG Competition sector enquiry. However we would underline that this enquiry did not include any evidence of any shortcomings in relation to transaction transparency.

The signatory associations believe that an overly burdensome transparency regime, based on pre- or post-trade transparency, with the burden of communicating data (to regulators, for publication) placed on market participants, could distort competition by discouraging potential new entrants faced with expensive compliance costs.

Similarly, an overly detailed and intrusive transparency regime could undermine the value of derivatives as hedging tools – the proposal to aggregate, in this context is welcome.

15. Do you agree with the results of the fact finding exercises and their analysis for the electricity and gas markets as described above? If not, please provide reasons for your disagreement?

Yes, in general, we agree with the results of the CESR-ERGEG fact-finding exercise on electricity and gas markets as described in paragraphs 208-217.

16. Is there any part of the electricity and gas markets (either spot or energy derivatives trading) where there is lack of pre- and post-trade information which affects the efficiency of those markets or a part of them? In any case, please provide examples and your reasoning.

Wholesale electricity and gas market participants have made clear on several occasions (in previous consultations) that the focus of transaction transparency should remain aggregated

post-trade data publication by exchanges, brokers and MTF, subject to some improvements, in order to ensure absolutely equal access to such data for the market.

We believe that pre-trade transparency requirements falling on wholesale market participants for wholesale electricity and gas markets would

- not be in keeping with the prime reasons for deployment of pre-trade transparency in other trading markets (i.e. equities, under MIFID) which relate primarily to protection of retail investors' interests: retail investors are not a factor in electricity and gas markets;
- reduce liquidity in electricity and gas derivative markets (by discouraging hedging activities) thus increasing volatility;
- be practically very difficult and burdensome to comply with in these markets, in particular for more bespoke, non-standardized contracts, which are subject to considerable negotiation;
- be of little benefit to the market, which sees no need for such rules;
- be so costly to comply with as to discourage potential new entrants.

The CDWG also observes that CESR and the European Commission have recently concluded that no failure exists in relation to market transparency in commodity derivatives.

17. Question 17 is blank on the consultation paper

18. Do you favour the status quo? Please provide reasons for your opinion?

CESR and ERGEG has recognized the previously views expressed views of the market, to the effect that policy in relation to transparency in the wholesale electricity and gas markets should focus as a priority on the use of essential infrastructure such as electricity transmission and generation, gas transportation and gas storage.

As recognized by CESR and ERGEG, market participants see no need for the imposition of pre- or post-trade transparency requirements being imposed at the level of each firm, and would oppose any such proposal.

The CDWG supports enhancement of trade data on standardized physical and derivative transactions published on a post-trade, aggregated basis by exchanges, MTFs and brokers.

19. Do you favour a key principles approach? If so, what characteristics should it have?

A 'principles-based approach', focusing on data to be published by exchanges, MTFs and brokers, would be acceptable to market participants.

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For example, we would suggest that aggregated post-trade data published by these infrastructures should

- Increase confidence of market participants in price formation and liquidity in these markets
- Be available to all market participants on an equal basis (e.g. at the same time, easily accessible)
- Use standardized definitions and formats to facilitate processing and understanding.

20. Do you favour a more comprehensive regime/initiative? If so, what would be its characteristics?

We agree with the conclusion of CESR and ERGEG in paragraph 250 that 'a comprehensive MIFID type regime for trade transparency is neither needed nor appropriate for energy markets.'

21. Do you agree with the preliminary analysis included in paragraphs (a) to (e)?

With regard to paragraph (a) we strongly oppose any suggestion that pre-trade transparency should be imposed on market participants for reasons already described, and any suggestion that transparency rules should be laid out according to the approach set out in option 3.

We strongly agree with the observation that there is 'little indication that the current levels of trade transparency in energy markets as a whole are not sufficient in practice' as mentioned in paragraph (a). We would suggest that mandating pre- or post-trade transparency for less-standardized OTC derivative and physical market transactions would both reduce their value to market participants (by undermining their value as risk management tools), would be of limited value to other market participants in understanding overall market developments (either at an aggregated or trade-by-trade level), given the customized nature of these transactions, and would imply significant compliance costs.

We believe the focus of post-trade aggregated transparency requirements should be 'platforms' (i.e. MTFs, brokers) and exchanges.

We agree with paragraph (b).

Concerning paragraph (c) we suggest that the views of market participants are highly relevant in deciding whether pre- or post-trade transparency would be of any benefit. The CDWG has made clear where it believes that transparency efforts should be focused.

We agree with the summary of potential negative effects of additional transparency requirements as listed in paragraph (d). We disagree with the conclusion that there would be little risk of trading shifting to third countries were regulation to be drawn up which was particularly intrusive. We believe that there are a number of third country markets that would benefit from EU over-regulation.

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We agree that, as stated in paragraph (e), aggregation, delay in publication and anonymity would somewhat mitigate the negative effect of transparency requirements. We agree that costs and benefits of different approaches have to be measured. However we point out that though uniform application of new trade transparency requirements would reduce the scope of regulatory arbitrage in the EU, application of intrusive, unpopular and costly regulation of this type (e.g. with the burden falling on individual firms, and regulators publishing this information) could leave scope, and considerable encouragement for regulatory arbitrage between the EU and other potential wholesale energy markets outside the EU.

22. What other views do you have on the matters covered in this section on trade transparency?

III Exchange of Information

23. Do you agree with the exchange of information between securities and energy regulators only on a case-by-case basis instead of a periodical and automatic exchange of information?

We view this as a matter for the regulators, as long as neither approach encroaches on the ability of market participants to engage in business.

24. Do you agree with the proposal of the establishment of multilateral and bilateral agreements between energy and securities regulators for exchanging information on cross-border and local basis respectively?

We view this as a matter for the regulators, as long as neither approach encroaches on the ability of market participants to engage in business.

25. Which securities regulator would you prefer to be responsible for providing the information required by the energy regulators regarding the transactions of a branch of an investment firm: the host Member State securities regulator of the branch or the home Member State securities regulator of the investment firm?

We believe that all information provided to energy and financial regulators should be provided on a home state basis (i.e. thus, investment firms and their branches should provide information to their home state (of the 'parent' investment firm) energy and financial regulators, and it should be up to these regulators to exchange information with their counterparts in other States as they see fit).

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