

June 20th 2011

ISDA's response to the CEER consultation on the introduction of a European-wide Energy wholesale trading passport

Introduction

On behalf of its members, the International Swaps and Derivatives Association (ISDA) takes this opportunity to comment on the Council of European Energy Regulators draft advice on the introduction of a European-wide Energy wholesale trading passport.

ISDA notes that this consultation is part of the ongoing initiatives which seek to enhance wholesale energy market efficiency, with the aim of establishing a single European energy market by 2014 and ISDA has been consistently supportive of these efforts. Most recently, ISDA has supported the draft legislation for the Regulation for Energy Market Integrity and Transparency (REMIT) as it should result in a more level playing field in trading between commodity market participants, addressing the current asymmetry of information through the imposition of new disclosure obligations upon market participants who own/control energy businesses and a prohibition on the use of inside information.

Considering the next proposed step towards convergence between financial regulation and energy trading regulation, ISDA welcomes the rationale behind the proposal for a wholesale trading passport in the European Union (EU), as it should lead to a reduction in costs of trading across the EU through the removal of inconsistent set up and access requirements which vary from Member State to Member State.

Before addressing the specific questions raised by CEER in the consultation, ISDA would like to highlight six key points in respect of establishing a European-wide energy wholesale trading passport namely:

1. Importance of a consistent EU-wide passport regime

Many ISDA members have experienced the manifold problems caused by inconsistent licensing processes and license obligations in many EU countries. As a result, ISDA agrees that these license regimes are one important reason for a lack of development of the various gas and electricity markets in the EU¹.

¹ There are other aspects that must be considered in improving European energy markets: differences in national network codes governing third party access to essential grid infrastructure and gas and electricity systems; lack of available physical infrastructure in some regions; fair, objective and non-discriminatory access to storage facilities in all markets; security of supply rules that are restrictive to cross-border trade; access conditions to energy exchanges and platforms.

We therefore concur with CEER's conclusion that a European-wide passport regime is the most appropriate way forward to address these issues. However, in order to reap the full benefits such a regime would bring, we believe it is essential, and it is made explicit, that any existing national regimes will be replaced by the European-wide energy wholesale trading passport. In the absence of this, the risk exists that national regulators will continue to require additional measures which will undermine the benefits accruing from these European-wide proposals. We note with concern that the EP's Committee on Industry, Research and Energy (ITRE) has conversely proposed to allow Member States to maintain their national license regimes and to create a mandatory EU license requirement for all other countries. This would lead to an enhancement of market barriers in countries with national license regimes and an increase of bureaucracy in countries without license regimes.

2. The need for an appropriately tailored regime

Given the specific characteristics, including the wholesale nature of these markets, we support the concept of an appropriately tailored authorisation regime for wholesale energy trading firms.

3. Third country energy traders access to EU market

ISDA members note that whilst CEER's proposals would result in a consistent framework for EU-based firms, for firms located in third countries it may introduce new requirements where none exist today (for instance, the UK does not require a firm to establish any legal presence or branch in the country as a condition of energy wholesale trading).

ISDA urges CEER to ensure that the introduction of a passport regime will not prevent, under appropriate conditions, traders from third countries to participate in the EU's energy markets, thereby reducing liquidity in the market. The regime should therefore allow for an appropriate transitional period to enable entities to remain active in the markets but to be obliged by the end of this transitional period to demonstrate adherence to the new EU-wide standards.

4. Harmonisation of penalties and sanctions

ISDA notes the CEER proposals to revoke a firm's license to trade in wholesale energy markets only in light of severe breaches. CEER recognises the need for collaboration and harmonised procedures in enforcing standards but, as CEER will be aware, enforcement powers and enforcement outcomes within the existing regulatory frameworks across the EU widely differ. Accordingly, ISDA considers it essential that steps are taken to ensure the regime is consistently implemented across Member States. Further, the implications of disciplinary action against a license holder in one jurisdiction for events occurring in another jurisdiction should be considered and we would welcome further detail how this process would be undertaken.

5. Coordination between Member States

Whilst acknowledging that effective collaboration is required between the host and home state regulatory authorities in implementing the authorisation and access regime, we look forward to receiving more clarity around how it will work in practice. We note CEER's proposals are in the early stages but we believe MiFID provides a useful model on Member State interaction in terms of apportioning roles and responsibilities.

6. Legislative vehicle for the wholesale energy authorisation regime:

We note CEER's view that the most expedient way of implementing the authorisation and access regime would be through its insertion into REMIT. We welcome steps which result in a more level playing field between commodity market participants and agree conceptually with this proposal although we question whether REMIT, which addresses market abuse, is the appropriate legislative vehicle for introducing an authorisation regime.

Responses to CEER consultation questions

Question 1:

(1a) Do you agree with the described analysis of existing licensing regimes in general?

(1b) Do you agree that differences in trading license requirements across EU Member States create higher costs for traders and create barriers to trade across Europe?

ISDA agrees that different national licensing regimes constitute a major obstacle to cross-border trading and increased competition in the EU wholesale gas and electricity markets.

It is ISDA members' experience that market newcomers can be discouraged from entering a market due to the divergent licensing requirements. These market entrants typically start on a smaller scale to investigate the market, to evaluate the opportunities available to them and develop a business model based on their findings.

The deterrent effect is reinforced by the numerous uncertainties relating to the licensing process. In particular, there is generally a lack of visibility available to market entrants in relation to:

- how long the license process will take;
- the practical implications of the licensing regime; and
- how the license regime will develop in the future.

In addition, the burden of on-going requirements reinforces these barriers to entry. In particular the development of reporting is not predictable and national reporting requirements require constant monitoring of different national laws.

Consequently, we would concur with CEER that harmonisation of a registration/ licensing regime is needed at European level, and we would further highlight that to be fully effective, national discretion around the implementation of such a regime should be prohibited.

(1c) If you do not see this as a problem, then please explain why?

See responses to 1a and 1b.

Question 2:

(2a) Do you agree with the objectives of the CEER policy advice identified in Chapter 1 of this document?

(2b) Are there any additional objectives that should be included?

ISDA supports the objectives but considers them as insufficient if they are not accompanied by a ban on national regimes. These objectives should not be limited to harmonising market entry barriers and the licensing process itself. The scope should include all on-going regulatory (license) requirements applied to energy wholesale trading, *i.e.* regulatory specifications becoming applicable after the license is issued. For instance, extensive reporting obligations cause substantive costs and require significant time and effort.

On a more general note, ISDA members see the risk that bureaucratic requirements applicable under existing national license legislation will be transformed into on-going obligations following the introduction of a European Passport.

Question 3: What are the main benefits and drawbacks of harmonising energy trading access across Europe?

ISDA views the main benefits being;

- The removal of cross-border barriers, which should lead to greater competition and reduce costs; and
- The establishment of consistent standards and a level playing field between commodity market participants.

As regards potential drawbacks:

- As we reference above, in the absence of making it explicit that any existing national regimes will be replaced by the European-wide energy wholesale trading passport, the risk exists that national regulators will continue to require additional measures which will result in duplicative requirements, thus undermining the benefits anticipated from these European-wide proposals.

- The network access requirements set by the Transmission System Operators (TSOs) are out of scope of the authorisation and access regime. However, in order to ensure that barriers to entry do not arise at this level, it will be important for the TSOs to be required to factor in the EU wholesale trading passport requirements when setting their own codes to avoid duplicative or conflicting requirements and that access to the transmission network is on an objective, transparent and non-discriminatory basis.
- As we note below, in response to question 6, it is critical that there is clarity and consistency around the scope of the wholesale energy authorisation and access regime and MiFID to ensure that there is no underlap and, where there is overlap, it is clear how each regime will apply, including coordination in relation to enforcement action.
- In terms of data collection, CEER envisages that ACER will compile a database, obtaining the information from each of the national competent authorities, which provides an overview of all wholesale energy trading participants active in the EU and a list of firms whose application has been rejected. Given the other regulatory initiatives underway, we would highlight the need to avoid the imposition of duplicating reporting and data collection requirements.

Question 4: Are there experiences or lessons to be learnt from the design and implementation of other similar regimes that we can use to inform our approach to the harmonisation of energy trading (for example the MiFID licensing regime)?

MiFID has shown that its European license mechanism is an effective tool to remove cross-border barriers.

The basic idea is that only one authority, the home regulator, has the power to license and supervise a firm which is active in several Member States and that host regulators can only initiate supervising measures through the competent home regulator. We would note that it is the ability to rely on equivalent levels of authorisation/supervision that allows the home/host approach to function; consequently to remove the incentive to ‘gold plate’ this licensing regime at a national level, the legislation needs to be as robust as that of MiFID. It should also recognise the equivalence of MiFID authorisation regime where appropriate, in order to remove the potential for firms to be subject to duplicative processes. Under these conditions, ISDA believes the concept on which the MiFID model is based will also work for the wholesale energy sector.

According to MiFID article 33 and 42, Member States must ensure non-discriminatory access to exchanges and other trading platforms. We encourage CEER and the European Commission to foresee a right of non-discriminatory access to energy exchanges, other energy trading platforms and relevant industry infrastructure e.g. TSOs. Currently, in some countries the application process for foreign companies is very burdensome, hindering market entrance.

However, ISDA draws attention to the fact that even a precise regime as defined in the MiFID does not exclude uncertainties concerning home and host regulator competence (for

instance on transaction reporting). As a consequence, ISDA would emphasize that effective coordination between regulators is a necessity for an efficient European passport regime.

We would also underline the need for adequate provision to be made for full engagement with stakeholders so that effective and efficient regulation results. In particular, we would welcome the development of key principles first, to be followed thereafter by the more detailed descriptive requirements.

Question 5:

(5a) Which of the options set out in Chapter 4 best achieves the CEER objectives?

As we reference above, in principle ISDA supports the introduction of European-wide wholesale energy passports and for it to be made explicit that any existing national regimes will be replaced by these requirements.

(5b) Are there other options that could achieve these objectives which have not been considered?

See question 5a.

Question 6:

(6a) What is your opinion on the suggested scoping, detailed requirements and administrative standards of a wholesale energy trading market access regime? Please explain the reasons for your views.

In general, and provided that the concerns raised above are appropriately addressed, ISDA would support a suitably calibrated authorisation regime that is tailored to the needs of the energy sector. In this perspective, wholesale energy traders should be subject to a competence regime appropriate to their activities and be able to demonstrate understanding and compliance with the appropriate regulations as part of the authorisation process, for example, compliance with the market abuse regime under REMIT. Within this context, we believe information regarding any criminal conduct/records relating to a member of a firm's management should be taken into account.

ISDA concurs that collateral should not be set by regulation and "existing institutions and trading arrangements are a better mechanism for setting collateral requirements" in this market.

We are also supportive of CEER's conclusions around administrative standards (including fees). In particular, ISDA believes that a cost-based fee approach for obtaining a trading license is appropriate, as well as the specification of the maximum duration of the application procedure.

(6b) Are there other or different requirements which should be included in such a regime?

From ISDA's perspective, and considering the example of the MiFID, it would be unacceptable that discretionary requirements could be applied by member states and by host regulators.