Europex

- Consultation response -

Increasing the global competitiveness of European commodity markets to strengthen the role of the euro in the field of energy

Brussels, 29 March 2019 | Europex, the Association of European Energy Exchanges, welcomes the opportunity to take part in the European Commission's *Targeted consultation on the role of the euro in the field of energy*.

As Europex is closely involved in the discussions about the European regulatory framework for wholesale energy trading, the present response will concentrate on what we believe is needed at EU-level to maximise the opportunities stemming from exchange-based energy trading to encourage a wider use of the euro for financial transactions in energy and energy related projects.

Europex members operate platforms for wholesale electricity, gas and environmental markets. Many of the contracts traded on these markets are denominated in euros. Although the decision to use a currency is ultimately made by the market, there is an important role the EU can play to foster the liquidity in contracts that are already denominated in euro. The EU can contribute to the success of these markets by creating a regulatory framework that is fit for purpose and ensures a high level of global competitiveness.

In order to achieve this aim, Europex believes that the European financial regulatory framework should be better calibrated for commodity trading. The current framework European energy exchanges are subject to, does not sufficiently take into account the specificities of commodity trading. Moreover, as European energy exchanges are subject to both financial regulation, such as the Markets in Financial Instruments Directive and Regulation (MiFID II / MiFIR) and the Market Abuse Regulation (MAR) as well as tailor-made regimes for energy trading, such as the Regulation on Energy Market Integrity and Transparency (REMIT), there is a high degree of regulation that is in conflict with the EU's objective of enabling attractive and competitive markets.

To emphasise this point more concretely, the present paper outlines two examples of elements in MiFID II/MiFIR that are not properly calibrated for commodities and prevent European energy markets from becoming more liquid. These two points relate to:

- Specific features of the position limits regime in Article 57 MiFID II; and
- The calibration of the pre-trade transparency requirements in Article 8 MiFIR.

1. Positions limits regime (MiFID Art. 57)

With the application of MiFID II/MiFIR as of 3 January 2018, all commodity derivative contracts in Europe, including euro-denominated energy derivative contracts, have become subject to a position limit on the size of a net position that a person can hold at all times in this contract. The limits, which aim at preventing market squeezing, are set as a percentage of the deliverable supply available in the underlying physical market with regards to spot month contracts and a percentage of open interest with regards to contracts expiring in all other months. Furthermore, Article 15 of RTS 21 has introduced a specific regime for new and illiquid contracts whereby a fixed limit of 2,500 lots is set for all months in contracts not exceeding 10,000 lots of open interest. In addition, contracts between 10,000 lots to 20,000 lots of open interest are eligible for a higher percentage limit of up to 40% of deliverable supply in spot month and open interest in other months.

So far, the newly introduced MiFID II position limits regime has worked in a reasonable manner for a number of well-developed benchmark contracts that are characterised by a large number of different types of active trading firms and an overall substantial amount of open interest. However, for the development of new products and further growth of existing illiquid energy derivative markets, the position limits regime has proven to constitute a substantial barrier. Fast growing markets in particular have suffered from (1) an increasingly restrictive limit as open interest increases, (2) an inflexible treatment in terms of their categorisation under the position limits framework and 3) an inaccurate reflection of the underlying physical markets. This barrier for developing illiquid contracts is also perceived as a barrier to more euro-denominated transactions and hence having a stronger international role for the euro in the field of energy.

Europex members have considerable experience in operating a position management system for their respective markets. Against this background, we consider that a proportionate and efficient position limits regime should focus on a limited number of benchmark contracts, similar to the way the U.S. has developed its position limits regime. Europex therefore recommends that position limits on new and less liquid contracts (i.e. contracts with an open interest between 10,000 and 20,000 lots) are suspended for an interim period to allow them to develop. Such an approach would provide for the necessary flexibility to allow fast-growing markets to thrive and to foster the development of new products without being restricted by disproportionately low position limits. Furthermore, it would be in line with the policy objective of MiFID II as expressed in its implementing RTS 21 which stipulates that:

"Position limits should not create barriers to the development of new commodity derivatives and should not prevent less liquid sections of the commodity derivative markets from working adequately"

2. Pre-trade transparency (MiFIR Art. 8)

Europex members have long argued that the MiFIR pre-trade transparency regime in its present form is not fit for purpose for commodity derivative contracts, such as energy derivatives. At present, the pre-trade transparency regime will even reduce transparency and undermine the price discovery process as well as limit the possibility of physical delivery to take place under the exchange / clearing house rules. This is because the waivers have not been properly calibrated for commodity derivatives.

As a consequence the pre-trade transparency regime is not only not fit for purpose, its impact is also in stark contrast to MiFID II/MiFIR's policy objectives, the 2009 G-20 Pittsburgh Commitments (i.e. higher transparency standards and the promotion of central clearing) as well as the Commission's aim to increase euro-denominated transactions in the field of energy.

About

Europex is a not-for-profit association of European energy exchanges with 26 members. It represents the interests of exchange-based wholesale electricity, gas and environmental markets, focuses on developments of the European regulatory framework for wholesale energy trading and provides a discussion platform at European level.

Contact

Europex – Association of European Energy Exchanges
Address: Rue Archimède 44, 1000 Brussels, Belgium
Phone: +32 2 512 34 10
Website: www.europex.org
Email: secretariat@europex.org
Twitter: Europex_energy