

Response to the ERGEG Public Consultation  
“Draft advice on the regulatory oversight of Energy Exchanges”

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## I. Introduction

EUROPEX welcomes the opportunity to take part in the ERGEG consultation regarding the “Draft advice on the regulatory oversight of Energy Exchanges” (hereafter “EEs”, a term which will be explained in the following).

As the European Council at its meeting on 4 February 2011 reiterated the objective by the 3rd Energy Package to create a fully integrated energy market by 2014 we are confident that this can first and foremost be achieved for wholesale energy markets. EEs are in so far some of the most visible results of the liberalisation of the energy markets in Europe. They provide trading platforms to various market parties like generators, transmission system operators (TSO), importers, distributors, banks, traders, brokers, industries and consumers buying and selling electricity, natural gas and emission allowances. Participation at the trading venues is generally voluntary<sup>1</sup> and accessible to all participants meeting admission requirements. The main objective of EEs is to ensure a transparent and reliable wholesale price formation mechanism.

Keeping this situation in mind our position paper in response to the ERGEG consultation strives for two goals:

Our first goal is to bring overall **clarity** in regards to essential points the consultation touches. Posing the overall question whether and how EEs should be regulated the consultation comprises several issues which do not necessarily have something in common and it is sometimes not obvious neither what the red line nor what the concrete intention behind are. For this reason our answer also enhances several questions which we would like to discuss in the upcoming debate.

Our second goal is to give indications on what measures are necessary to further **foster the development of Energy Exchanges** by establishing a common legal or regulatory oversight/supervision framework of Energy Exchanges. With Energy Exchanges playing an important role in today’s liberalised energy markets, REMIT coming into force soon, reviews of MiFID and MAD being in progress and various European and national energy regulatory frameworks in place, a dedicated and clarifying discussion on the future of the legal/regulatory oversight of Energy Exchanges comes at the right time.

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<sup>1</sup> However, participation at trading venues is mandatory for certain markets or products in some member states.

We are looking forward to take part in a fruitful consultation process and are open to any questions or further discussions.

## II. Clarification

### **1. Before determining regulatory measures the reason behind and the overall goal of the consultation need to be clarified**

The consultation already proposes certain regulatory measures. It is not evident though what the initial basis and the goal of the consultation are and where ERGEG sees concrete room for improvement with regard to the functioning of EEs in their current regulatory frameworks.

For the overall understanding of the status of EEs in Europe it is important to note that EEs status of being a profit or a non-profit organisation, being mandatory or non-mandatory, differs due to national legal regimes and economic conditions. This diversified structure does per se not constitute an unsatisfying situation. EEs operate already today efficient, well-functioning and compatible markets.

### **2. Role and function of an Energy Exchange**

The many differences between EEs both in terms of regulatory regime and products traded make it necessary to clearly define what the consultation understands by EEs, which is not always trivial:

- Does it refer to spot markets only or also to derivatives markets?
- Does energy mean only electricity or also natural gas and emission allowances?

ERGEG's consultation probably concerns both spot and derivatives markets in the electricity and natural gas sectors. Nevertheless, this paper focuses on spot markets for natural gas and electricity. Regulated entities under financial regulation should not be double regulated.

EUROPEX would first like to clarify what the **role and the functions of an Energy Exchange are**, beyond the definitions for Regulated Markets (hereafter “RM”)<sup>2</sup> and Multilateral Trading Facilities (hereafter “MTF”)<sup>3</sup> as defined in Directive 2004/39/EC.

In both cases, such venues are defined as *“trading [facilities] that [bring] together multiple third-party buying and selling interests [...] in the system and in accordance with non-discretionary rules – in a way that results in a contract”*. This definition might also apply to market places organising spot markets. Generally EEs provide the following common functions:

- Organising and maintaining constantly fair and orderly markets;
- Organising price formation and trading in an anonymous, transparent and non-discriminatory manner;
- Informing clearing and delivery bodies (when the Exchange does not provide these functions directly) of the trades conducted on its platform;
- Publishing price references and other adequate information;
- Ensuring participants respect the market rules;
- Reporting to the NRAs or other competent authorities;
- Developing and maintaining the relevant systems, resources and organisation to perform the above functions.

Depending on the legal and regulatory situation in the Member States the performance of these functions are subject to different requirements/constraints (e.g. depending on the dialogue with market participants and/or approval or oversight by NRAs or other competent authorities).

These core functions apply to all EEs, irrespective of the regulatory framework in which they operate, and the nature of the services or functions they may provide (e.g. market coupling, fundamental data publication, IT ancillary services to third party markets, shipping, clearing, etc).

Starting from these core functions, we can then define what should be the scope of the regulatory framework applying to EEs.

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<sup>2</sup> Article 4(14) of MiFID

<sup>3</sup> Article 4(15) of MiFID

### 3. Wording clarification: Definition of “regulation”, “oversight” and “monitoring”

Another point we would like to clarify concerns the terminology used throughout the paper, which is about “Regulatory oversight of EEs”. The paper uses alternatively the terms “oversight”, “regulation” and “monitoring” without providing a clear definition for each of those terms.

However, as they comprise very different obligations, it is essential to make a distinction between these terms, and, once this exercise has been made, to carefully assess how each of them applies to EEs.

**“Regulation”** means a rule of order either at European, national or international level prescribed by a superior or competent authority, relating to the actions of those under the authority's control.

**“Oversight” (or “Supervision”)** means the power/duty of an authority to check the compliance of the activities of those under its control with the prescriptions established by law or the applicable regulation. In financial markets, such general requirements are applied by Multilateral Trading Facilities and regulated markets under a European regulatory framework. Within this framework they are subject to compulsory oversight/supervision by financial regulatory authorities. In energy regulated markets such as OMEL, Nord Pool Spot, GME and OTE compulsory oversight/supervision by energy regulatory authorities also applies according to legal national/regional frameworks, taking into account EU-principles and rules. However a common and harmonised EU framework applying to EEs as such does not exist yet.

**“Monitoring”** refers to regular observation and recording of the market participants' behaviour in order to check the quality of the price formation. On energy markets, this activity is carried out on a daily basis through cooperation between EEs, which report the data of their markets, to NRAs or other competent authorities which are ultimately in charge of analysing this data.

## 4. Observations on the fact findings of the consultation

### 4.1 EEs operate under different legal requirements: Normally they are active in a competitive environment

Despite the fact that EEs have the same core functions, one should keep in mind that they operate under different legal and regulatory frameworks in Member States. Thus we would like to distinguish between the following models:

- EEs such as OMEL, GME and OTE which operate under exclusive rights established by their national energy regulations;
- EEs that operate for all of their activities within a dedicated legal framework, such as, for instance, EEX and Belpex;
- EEs like Nord Pool Spot and Belpex that operate under a licence provided by a ministry or an energy regulator;
- EEs that operate as standard commercial entities with no specific regulatory framework, such as, for instance, EPEX Spot;
- EEs like APX-ENDEX and Powernext which operate under two different regimes.

OTC and brokers' platforms operate in parallel with EEs<sup>4</sup> offering both natural gas and electricity products. Despite the fact that EEs provide trading for standardised products only while OTC provide standardised products and non-standardised and tailor-made products for natural gas and electricity, some of the OTC market services are complementary to, and partly substitute, EEs products. The liquidity periodically passing from OTC to EEs proves that both perform partly complementary and partly substitute functions. Therefore, even in countries where there is only one EE, it cannot be considered being in a monopolistic position when OTC coexist.

In the context of REMIT which applies to all energy trading, and referring to the definition of "regulation" we provide above in Section 2., all regulatory or legal measures (such as the ones

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<sup>4</sup> Moreover, some EEs can also compete with each other: this is for instance the case on some gas markets where some EEs offer contracts to be delivered on the same hub (e.g. TTF with APX-ENDEX and EEX) and also in the UK for electricity.

discussed in ERGEG's consultation paper) should not exclusively apply to EEs but to all trading venues equally where OTC coexist.<sup>5</sup>

#### **4.1.1 Gas exchanges operate in a highly competitive environment**

Several European Energy Exchanges operate spot and futures markets for natural gas while others consider launching such markets when the underlying infrastructures, transmission rules and market conditions will allow it.

As compared to electricity markets, most natural gas markets in Continental Europe are still in an early stage of development. Particularly in trading hubs where liquidity has developed (e.g. Dutch TTF, UK NBP, German NCG and French PEGs), EEs are faced with competition from the OTC market (e.g. brokers) who hold dominant positions in all continental gas hubs as well as competition from other EEs in some cases.

The majority of European Gas Exchanges are thus still at the stage of developing liquidity by acquiring new members and attracting trading volumes in a highly competitive environment. In some parts of Europe, they have to gain their market shares by the quality and cost of the service they are proposing.

Regulatory oversight/supervision rules for Gas Exchanges should take the above mentioned context into account and leave sufficient flexibility to Gas Exchanges to build liquidity at this early stage of development.

#### **4.2 Regulation of the fees of Energy Exchanges**

The question concerning the fees of EEs is mentioned several times in the paper. EEs fees reflect the costs of efficient services in terms of operation, ensuring anonymity, transparency and non-discrimination between the market participants, thus enhancing competition between buyers and sellers.

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<sup>5</sup> With regards to the specific rules applying to the market coupling activities performed by EEs, please refer to chapter 4.3.



There are different approaches to fees:

- In the case of regulated EEs, such as OMEL, Nord Pool Spot, GME and OTE, income and/or profit is regulated in a specific manner: it is fixed by taking into account the general interest, the interests of the consumers, market models, competition with OTC, etc.
- For non-regulated EEs, these fees are not decided arbitrarily either, but they take into account customer needs, market models, etc. Competition pressure with OTC and between EEs ensures that the fees remain competitive.

The most important point is that fees respond to market needs whilst remaining competitive. The regulatory framework of each Member State ensures that EEs fees are fixed in a competitive manner.

### **4.3 Focus on the specific case of market coupling in electricity**

Considering the importance that market coupling has in the consultation paper, we think it is necessary to give the following precisions on this specific activity, its scope and its impact on EEs' activities and related regulatory framework.

Cross border trading generally constitutes only a small share of the activity of EEs (this varies from EE to EE), although it is very critical in the aim of creating an integrated European electricity market. As stated above, the core function of EEs is to operate anonymous, transparent and non-discriminatory market places that meet buyers' and sellers' interests – often for a range of different commodities. The performance of these core functions enable some EEs to perform market coupling activities in an efficient manner.

It is true that market coupling/splitting mechanisms combine in the same act energy prices formation, the core activity of EEs, and capacity allocation. But in this case the aspects of market coupling related to implicit capacity allocation should be seen as a specific activity which could be regulated in itself, with no spill-over effect on the governance of the other EEs functions.

This regulation of market coupling activities of EEs is already in place: either through market coupling services contracts of some EEs with TSOs (which are themselves regulated by the

Energy Regulation); or within the energy Regulation applying directly to EEs operating their market coupling functions.<sup>6</sup>

### III. Proposal for an oversight/supervision framework of Energy Exchanges

#### 1. The principle of subsidiarity must be acknowledged

It should be carefully considered and analysed whether in the light of the EU's subsidiarity principle legal or regulatory requirements provided by the Member States are a sufficient basis for the functioning of Energy Exchanges. As mentioned above, the fact that there are different forms of EEs throughout Europe is due to the situation that there are different legal systems in place. Diversity in itself is one of the characteristics of the European market and does not necessarily constitute a problem that needs to be solved. If it can be proved that problems originate from diversity, harmonisation, in the sense of setting sufficient minimal common standards, is the appropriate reaction and not the regulation of the entire market design.

#### 2. Oversight/Supervision of the Energy Exchanges' compliance towards their core functions constitutes a general requirement

EEs operate their markets in a fair and orderly manner in accordance to the different rules in the Member States. In financial markets, such general requirements are applied by Multilateral Trading Facilities and regulated markets under a European regulatory framework. Within this framework they are subject to compulsory oversight/supervision by financial regulatory authorities. In regulated energy markets such as OMEL, Nord Pool Spot, GME and OTE compulsory oversight/supervision by energy regulatory authorities also applies under legal national/regional frameworks, taking into account EU-principles and rules. However, a common EU harmonised framework applying to EEs as such does not exist yet.

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<sup>6</sup> In some cases, a mix of both models is applicable.

In this context EUROPEX is in favour of a harmonised, principle-based European oversight framework for Energy Exchanges whatever their respective national legal or regulatory situation is. The development of such a harmonised oversight framework should take into account already existing EU regulatory oversight frameworks. This regulatory oversight framework shall not be understood in the sense of an entire market design regulation.

NRAs or other competent authorities should supervise the compliance with the general requirements while ensuring the necessary flexibility for running the markets.

Concerning oversight, this implies that each EE can refer to a designated competent authority performing this oversight/supervision task. For EEs operating in more than one Member State, this also implies harmonisation on two levels:

- EU level harmonisation of requirements applicable to EEs as regards the general principles of organisation of their markets;
- EU level harmonisation of competent authorities' mandates as regards their oversight/supervision role in order to avoid gaps or, on the contrary, overlaps of competences.

### **3. General requirements for the organisation of EEs to be subject to NRAs' or competent authorities' oversight/ supervision**

General minimum requirements for the organisation of EEs include:

- Management of systems ensuring orderly trading and efficient price formation;
- Transparency of information relevant to confidence of price formation;
- Non-discriminatory access requirements and provisions for the execution of trading;
- Market abuse monitoring and obligation to report findings of abusive actions to relevant authorities.

**For clarification purposes, note that the oversight/supervision and harmonisation of the general principles of the organisation of EEs' is to be distinguished from, and should not go as far as, the harmonisation and the regulation of the whole market design.**

Markets run by EEs have to adapt to different situations in the Member States. It therefore does not make sense to have common exchange rules if the infrastructure and the legal constraints EEs have to abide with are different. Therefore, regulating EEs' entire market design in the name of harmonisation seems to be a misleading idea. In order to ensure more efficient markets, the harmonisation of the role of NRAs and the framework of cooperation between NRAs and the other authorities in their tasks of market oversight/supervision and monitoring would be a more essential point.

For the time being it is too early to give a precise advice regarding the legislation under which such an oversight should be handled. Nevertheless, already existing requirements should be taken into consideration.

#### **4. An essential prerequisite: The harmonisation of the NRAs' role**

Energy regulators are close to energy markets and have developed a high competence in this field over the last decade. It should be taken into account that competitive markets places – such as EEs – may be additionally subject to the supervision of other authorities such as cartel offices.

Should the focus be on the oversight/supervision and monitoring of EEs markets, as suggested in this paper, a certain harmonisation of NRAs' or competent authorities' missions would be necessary to ensure that this is done efficiently, especially with regard to EEs operating in more than one Member State. In that respect, NRAs' or other competent authorities' mission:

- should not only focus on the regulation of the energy system but make sure that they support fair, orderly and transparent trading venues through market oversight/supervision and market monitoring (see 4.2 and 4.3);
- should not mix-up issues of system regulation and trading oversight/supervision, which relates to different constraints and supervision needs;
- should include close cooperation between each other so that they can get the information which is necessary to conduct their missions at a pan-European level directly or through their partners;
- should define more clearly the cooperation framework with the EEs and all other trading facilities with respect to the market surveillance and reporting obligations of the latter.

## 5. REMIT first

The successful implementation of REMIT should also be an important goal. With REMIT constituting a big step into the right direction, it is now of utmost importance to implement the new regulation Europe-wide. Regulation may need a certain implementation period to discover possible shortcomings. The main issues, e.g. in regard to market surveillance as mentioned in the consultation document, are already well addressed and well situated in the REMIT:

- Obligation of participants to transmit all relevant information to the market surveillance;
- Respective roles of Energy Exchanges and NRAs in case of suspicion of misbehaviour;
- Harmonisation of the disciplinary process across member states.

These topics should remain under the REMIT framework because REMIT aims at all actors in the wholesale energy markets, applying also to EEs as to broker platforms and OTC.

Transparency and market monitoring issues are also regulated by the REMIT framework. Indeed, REMIT is targeted at all actors in wholesale energy markets, applying also to EEs as to broker platforms and OTC. In this way, European legislators could avoid the risk of an overregulation of a specific market segment and the subsequent risk of regulatory arbitrage.

Moreover, REMIT lays down a uniform regulatory framework for transparency issues arising from the energy trading.

For a relevant regulatory plan to ensure transparency and integrity of wholesale energy markets, the mandate and the territorial competence of NRAs on monitoring should be clearly defined in order to ensure that each EE is monitored by a designated NRA in a consistent manner. This principle should take into account the fact that some EEs (operating derivatives markets) are already under supervision or monitoring of a financial services authority under MiFID, and that overlap between the regulation applicable to the energy sector and MiFID should be avoided.

Main issues e.g. in regard to market surveillance as mentioned in the consultation document are already well addressed by the REMIT draft:

- Obligation of participants to transmit all relevant information to the market surveillance authority;
- Respective roles of Energy Exchanges and NRAs in case of suspicion of misbehaviour;

- Harmonisation of the disciplinary process across member states

Please note that many Energy Exchanges actually have implemented market surveillance offices on a voluntary or mandatory basis checked - and in some member states also approved – by NRAs or competent authorities. "Market surveillance" though does not necessarily mean the existence of a special market surveillance office. Energy Exchanges should in so far remain free to organise the market surveillance in a way that it best fits the market needs (taking into account its size, nature, maturity, nature of the publicly available information, etc.).

## **6. Fundamental Data Transparency: Using existing infrastructure**

Currently, we witness an extensive debate on what infrastructure is necessary in order to collect data from the energy sector both for integrity monitoring (e.g. REMIT) and for transparency publication (e.g. ERGEG Draft Comitology Guidelines on Fundamental Electricity Data Transparency).

First of all it is therefore important to point out that already today a high degree of infrastructure exists both for trading data (e.g. prices, volumes) as well as for fundamental data (e.g. data on the production of electricity). A big portion of this infrastructure has been established by Energy Exchanges either as a legal requirement or on a voluntary basis.

Transparency standards both on a regulatory as well as on a voluntary basis have been remarkably improved in recent years by existing transparency platforms. Nevertheless, the desired goal of fully harmonised transparency standards across all of Europe has not been achieved yet.

This objective should be achieved by the harmonisation of already existing transparency platforms rather than to create a new platform from scratch.

The obligation for power plant operators to provide transparency would be fulfilled once they have sent their data to one transparency platform. They should not have to send data to several transparency platforms.

The harmonised transparency platforms would not send data they receive from power plant operators on to another platform. Competent authorities such as ACER would have direct access to the data on all established platforms.

As a consequence of this harmonisation, it would be assured that the users of transparency platforms (e.g. traders, regulators, journalists and interested public) experience the same common standards all across Europe.

Advantages of this policy option – which potentially saves money and time – would be:

- Existing reporting structures can be further used.
- IT-infrastructure of existing transparency platforms can be further used.
- On-going improvements of existing platforms are not interrupted.
- Responsibility for running the transparency platforms lies with the operators which have many years of experience in the different regions, especially with regard to the publication of power plant data.
- Market Surveillance Offices of Energy Exchanges or similar departments of the EEs can further control the disclosure of information and can detect any misuse as they have insight knowledge on how the actual information impacts pricing.

## **7. No regulatory issue with regard to market making**

Generally, EUROPEX does not see the need why there should be a special legal treatment of market makers at the EU level.

A market maker is a trading participant who ensures basic liquidity by holding a bid and an ask order (quote) simultaneously for a minimum period of time and for a minimum volume on the exchange trading day. In terms of settlement and physical delivery, if that is the case, market makers follow exactly the same rules as any other agent: they have both a financial and a physical obligation if the contracts are physically settled (which applies to spot markets and some derivatives models), whereas in derivatives contracts that are exclusively cash settled they only have a financial obligation.

The treatment of market makers varies according to the legal and regulatory framework in member states and to the different kinds of electricity markets:

- In spot auction markets market makers generally do not exist, with the exception of EXAA. In some of these markets there are other regulatory provisions in order to ensure that the available physical assets appear, either in bilateral contracts or in the organized market, although these provisions cannot be included in the market making concept.
- In continuously traded markets market makers can be key to develop the liquidity of an Exchange market and exist at most EEs. Such bilateral agreements are open to all market participants.

The Energy Exchanges where market makers exist today cannot agree with the ERGEG comment “potential conflicts of interests [are] possibly arising if a market maker is also a producer” and the conclusion that legal requirements should be enacted to avoid potential conflicts of interests.

Indeed, market making is based on bilateral agreements on a private law basis. Members who sign these agreements typically benefit from a reduction of their trading fees when they trade (depending on the volume traded and the length of the Bid/Ask spread quoted); however, as they sign these contracts on a voluntary basis, if they do not fulfil the foreseen objectives they do not receive the financial incentive. These agreements do not induce an obligation to trade for the market makers.

The concept and the role of market makers though have to be clearly differentiated from the market power issue and the monitoring and control of that potential market power abuse, as this particular case of manipulation is already specifically monitored by market surveillance authorities and NRAs or other competent authorities, and is totally independent of the market making activity.

At the current state we do not see why a regulation of market making should be justified.

All agents, including producers/big utilities, should be eligible for the market making activity. New continuously traded markets in energy need market makers to develop their liquidity. If



producers are not allowed to become market makers, this could hamper the development of wholesale energy markets.

## IV. Answers to the questions of the consultation

- 1. In your view, is there a need to create EU level requirements for the organisation, functioning and regulatory oversight of EEs not falling within the scope of MiFID? If yes, what should be the main goals and objectives to be fulfilled?**

Please refer to:

- chapter II Nr. 4.3: Focus on the specific case of market coupling in electricity
- chapter III Nr. 1: The principle of subsidiarity must be observed
- chapter III Nr. 2: Oversight/ Supervision of the Energy Exchanges' compliance towards their core functions serves as a general requirement
- chapter III Nr. 3: General requirements of Energy Exchanges' organisation to be subject to NRA's or competent authorities' oversight/supervision

- 2. In your view, what are the remits of national energy regulators in supervising EEs and how could a beneficial cooperation between them be organized, in particular for exchanges active under multiple national jurisdictions?**

Please refer to:

- chapter III Nr. 4: An essential prerequisite: The harmonisation of the NRAs' role

- 3. Should the regulation of energy spot exchanges in future be covered by the energy market integrity regulation or by a separate future legal proposal by the European Commission?**

Please refer to:

- chapter III Nr. 1: The principle of subsidiarity must be observed
- chapter III Nr. 5: REMIT first

**4. How could in your view a harmonisation of legal and operational frameworks stimulation of the European EEs and what is the best way to involve the market/exchange participants?**

Please refer to:

- chapter III Nr. 1: The principle of subsidiarity must be observed
- chapter III Nr. 2: Oversight/Supervision of the Energy Exchanges' compliance towards their core functions serves as a general requirement

The existing mechanisms for the involvement of market participants at Energy Exchanges differ depending on their respective legal and regulatory frameworks. All of these mechanisms already ensure an efficient involvement of market participants. If they did not Energy Exchanges would run the risk of losing those market participants.

**5. Which criteria should a European framework for market makers include to avoid potential conflicts of interests?**

Please refer to:

- chapter III Nr. 7: No regulatory issue with market making

**6. How could national energy regulators better work towards publishing of price sensitive information as e.g. foreseen in the ERGEG advice on Guidelines on Fundamental Electricity Data Transparency to the increase the level of transparency?**

Please refer to:

- chapter III. Nr. 6: Fundamental Data Transparency: Use existing infrastructure

**7. Which measures could in your view lead to a sufficient cooperation of market surveillance departments of the EEs and the national energy regulators?**

Please refer to:

- to chapter III Nr. 5: Remit first

Main issues e.g. in regard to market surveillance as mentioned in the consultation document is already well addressed by the REMIT draft:

- obligation of participants to transmit to the market surveillance authority all relevant information;
- respective roles of Energy Exchanges and NRAs in case of suspicion of misbehavior;
- harmonization of the disciplinary process across Member States

Please note that many Energy Exchanges actually have implemented market surveillance offices on a voluntary or mandatory basis, checked - and in some member states also approved – by NRAs or competent authorities. "Market surveillance" though does not necessarily mean the existence of a special market surveillance office. Energy Exchanges should in so far - unless they are under specific regulation or license obligations in relation also to market surveillance - remain free to organise the market surveillance in a way that it best fits the market needs (taking into account its size, nature, maturity, nature of the publicly available information, etc.)

**8. What are in you view minimum standards for a harmonised approach to protect EEs from misbehaviours like market abuse?**

Please refer to:

- Chapter III Nr. 5: Remit first