CEER

Council of European Energy Regulators

Fostering energy markets, empowering **consumers**.

ESMA Consultation Paper on the impact of position limits and position management and on weekly position reports

CEER response

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Annex I - Part 1

Answer to Question 2:

Do you agree that the C(6) carve-out creates an unlevel playing field across trading venues and should be reconsidered? If not, please explain why.

1. Introduction

CEER welcomes the opportunity to comment on ESMA's Consultation Paper. On behalf of the European Energy Regulators, we wish to respond with the following remarks.

In recent years, CEER has followed the developments in regulation of financial markets attentively (and in particular in MiFID II and MiFIR) and has eagerly contributed to the discussion. Energy regulators remain supportive of the objectives of MiFID II to improve conduct in financial markets.

We also welcome the good cooperation between financial and energy regulators which we have had over these years. In this respect, CEER has long supported the principle of ensuring coherence and consistency between, on the one hand, financial regulation, and on the other hand, the respective regulation for electricity and gas markets – especially the Regulation on Wholesale Market Integrity and Transparency (REMIT) and that those two regulations are complementary.

The ESMA consultation aims at reconsidering the C (6) carve-out, based on two main arguments:

1) there is an unlevel playing field for regulated markets and MTFs compared to OTFs, resulting in the shift in trading on the latter venue as a consequence of the C (6) exemption regime, and

2) the principle that the same rules should apply to the exact same contracts independently of the EU trading venues where those contracts are traded, which is not the case of current framework: MiFID II/MiFIR requirements are not applied to the contracts respecting C (6) carve-out criteria and falling, therefore, under REMIT regulation for which ESMA does not find a justification.

CEER does not agree with ESMA's analysis that the C (6) carve-out creates an unlevel playing field across trading venues. We are concerned about ESMA's proposal to reconsider the C (6) carve-out exemption, where reconsideration would aim to reduce the scope of application of the carve-out. **It is therefore CEER's position that the carve-out should not be reconsidered in a restrictive way**.

2. Reasoning behind the existence of the C (6) carve-out

ESMA's consultation states that: "*Unsurprisingly, the C (6) carve-out has proved a significant and successful incentive for market participants to move trading in REMIT contracts to OTFs and is the source of a major competitive disadvantage for regulated markets and MTFs, **which ESMA can find no justification for***".

ESMA further indicates that: "*More fundamentally, ESMA considers that the same rules should apply to the same instruments independently of the EU trading venues where those instruments are traded and that* ***the logic for any such differentiation remains unclear***".

CEER considers that the ESMA statements above are not correct as regards practices in the energy markets, and that the carve-out can be fully justified for the following reasons:

First of all, CEER would like to recall why the EU decided to set up a tailor-made European legal framework – REMIT – for the energy sector and why the C (6) carve-out was introduced in MiFID II. The main business of energy companies is the production and/or supply of electricity or gas. Energy companies use derivatives as a way of hedging (managing production and supply risks) and do not pose a systemic risk to the financial system nor do they pose any risk to private investors. Having in mind that these circumstances have not changed from previous years and from the previous regulatory framework, CEER does not see the need to change current arrangements and restrict the C (6) carve-out.

Secondly, CEER would like to recall that gas and electricity markets have their own dedicated regulation to address market abuse and transparency – the REMIT regulation. REMIT and MiFID II both have the main goal to bring more integrity and transparency to energy and financial markets, respectively. REMIT foresees that each national regulatory authority has the investigatory and enforcement powers necessary to exercise the prohibitions against market abuse (article 13). It should be taken into account that, since REMIT's creation in 2011, energy regulators have gained extensive experience in monitoring the trading of wholesale energy products.

This is reflected in the recent sanctioning decisions taking into account energy particularities that do not pertain to financial markets, which confirm that energy regulators are best placed to exercise such supervisory functions.

Therefore, CEER considers that if the C (6) carve-out was to be reconsidered in a restrictive way and energy regulators were to be replaced by Financial Regulators in supervision tasks for the concerned products, this would be inappropriate, inconsistent and inefficient considering the experience gained in this field by energy regulators.

3. No shift from regulated markets and MTFs to OTFs

Since the introduction of OTFs and the C (6) carve-out, trade volumes in this segment have significantly increased. CEER highlights that this growth of trading towards OTFs was actually the intention of the EU when first introducing OTFs in MiFID II.

Nevertheless, without quantitative data supporting ESMA's statement from the consultation text, there is no demonstration that there has been a significant shift of trading in physically settled wholesale energy contracts from regulated markets and MTFs to OTFs.

According to information known to CEER, the findings are rather supporting the contrary – an increasing share of exchange-executed or cleared transactions is observed since the introduction of OTFs.

Finally, CEER also considers it is relevant to remember that an exception already existed before MIFID II (wholesale energy products traded on the non-MTF platforms) and

fundamentally OTF platforms did-not create a disbalance but made the existing framework clearer.

4. Possible consequences of reducing the scope of application of the C (6) carve-out

In addition to the arguments mentioned above, CEER is also concerned that a reconsideration of the C (6) carve-out in a restrictive way would result in unintended consequences which might endanger the integrity and transparency of wholesale energy markets.

First, a change of this nature, could imply the necessity for an energy company to apply for an authorisation to operate as an investment firm, and to put in place an organisational setup for MiFID II/MiFIR compliance. This would create additional costs and could slow down their activity on energy markets.

Second, to circumvent this, such companies might be incentivised to rely on more bilateral trading. This would lead to less transparency and less regulatory control compared to the current situation and hedging would become more expensive for European energy companies.

Less efficient and more expensive hedging may lead to higher prices being paid by consumers.

5. Conclusions

Bearing in mind the above stated arguments and taking in account that there is no evidence that the existing C (6) carve-out has resulted in any negative effects on the functioning and stability of the financial markets, CEER strongly advises not to revise the existing legislation in a restrictive way and to confirm the continuation of the C (6) carve-out for wholesale energy contracts with physical trades for the delivery of gas or electricity at a future date.