

**CEER Draft Advice
on the introduction of a Europe-wide
Energy Wholesale Trading Passport**

A CEER Public Consultation Document

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INFORMATION PAGE

Abstract

This document (C11-WMS-15-04) sets out CEER's draft advice on a framework for dealing with the existing shortcomings regarding regulatory access to trading on electricity and gas wholesale markets.

The final advice will aim to support policy makers on EU and national level to make informed decisions on next steps.

Target Audience

Energy suppliers, traders, gas and electricity customers, gas and electricity industry, consumer representative groups, network operators, Member States, academics and other interested parties.

How to respond to this consultation

Deadline: **17 June 2011**

This public consultation is carried out through a dedicated online questionnaire on the European energy regulators' website. To participate in the consultation please go to

http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_CONSULT/OPEN%20PUBLIC%20CONSULTATIONS/Europe-wide%20trading%20passport

and fill in the login request form. You will be provided with a login and technical instructions for the questionnaire.

If you have any queries relating to this consultation document or to the online consultation, please contact:

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All responses except confidential material will be published on the website www.energy-regulators.eu.

Treatment of Confidential Responses

In the interest of transparency, CEER

- i) will list the names of all respondents (whether confidential or not) or, alternatively, make public the number (but not the names) of confidential responses received;
- ii) requests that any respondent requesting confidentiality submit those confidential aspects of their response by marking them as “confidential” in the dedicated online questionnaire. CEER will publish all parts of responses that are not marked confidential.

For further information on CEER’s rules, see CEER Guidelines on Consultation Practices¹.

Related Documents

CEER/EREG documents

- “EREG and CESR advice to the European Commission in the context of the Third Energy Package - Record-keeping, transparency and exchange of information”, December 2008, Ref. C08-FIS-07-03, http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_EREG_PAPERS/Cross-Sectoral/2008/C08-FIS-07-03_Recordkeeping_2008-12-17.pdf
- “Wholesale energy trading licenses in the EU”, Brattle Group/ Skadden, Arps, Slate, Meagher, & Flom UK LLP, 21 October 2010, http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_EREG_PAPERS/Cross-Sectoral/2010/Brattle-Skadden%20Study%20Licensing%2021%20Oct%202010.pdf

External documents

- “Conclusions on Energy”, European Council, 4 February 2011, Ref. PCE 026/11, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/119141.pdf

¹ http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_EREG_PAPERS/Founding%20Documents%20and%20Rules/Founding%20Documents/E07-EP-16-03_PC-Guidelines_CEER.pdf

Table of Contents

1.1	Background.....	8
1.2	The process to date	9
1.3	Objectives of the policy advice	9
1.4	Questions for Public Consultation	10
2.1	Wholesale energy trading licensing regimes in the EU Member States	12
2.2	European level financial legislation – MiFID Passport	13
3.1	Challenges in law enforcement	15
3.2	Necessity and degree of checks for potential market participants	16
3.3	Administrative standards	18
3.4	Recommendations concerning scoping, requirements and administrative standards of a wholesale energy market trading access regime	19
4.1	Continue with the status quo	21
4.2	Extension of MiFID passport to electricity and gas trading	22
4.3	National licensing regimes with a set up of minimum and maximum requirements.....	22
4.4	Europe-wide Energy Wholesale Trading Passport	23
4.5	Conclusion on the implementation options	24

EXECUTIVE SUMMARY

Background and objective of the report

Complementary to its advice on the development of a tailor made oversight regime for the wholesale electricity market², the Council of European Energy Regulators (CEER) – at the request of the European Commission – is engaged since 2009 in the issue of analysing the regulatory access to wholesale energy trading as another key element on the way to create a Single European Energy Market and to ensure the integrity of energy trading in Europe.

CEER commissioned an external study in 2009 which was finalised in autumn 2010. The objective was to determine whether existing licensing requirements serve important policy goals, or harm competition by serving as unnecessary barriers to market entry. Results were discussed at the Madrid and Florence Fora as well as in separate meetings with selected stakeholders.

The study and discussions confirmed that currently a huge variety of different rules and regimes regarding the access for trading companies to energy wholesale markets exists. This poses serious administrative burdens and barriers for more competition in the wholesale energy markets. Several of the current licensing requirements in European countries are perceived as serious market entry barriers especially for trading companies that want to be active in several countries. Furthermore, as there are countries with no access requirements, it has to be noted that in those markets a minimum quality of trading companies might not be guaranteed. A consistent overview of market participants actually acting on the market is missing.

The current CEER draft advice is based on the results of the above mentioned process. It sets out a framework for dealing with the existing shortcomings regarding regulatory access to trading on electricity and gas wholesale markets along the lines which were presented and welcomed at the Florence Forum in December 2010. It provides recommendations on whether harmonisation of wholesale market trading access conditions is needed and if yes, what would be the best instruments to achieve it. The recommendations are intended to support policy makers at EU and national level to make informed decisions on next steps.

Conclusions and key messages

Scope of a regulatory access regime to wholesale energy trading

CEER clearly concludes that there are objective reasons for regulating the access to trading on electricity and gas wholesale markets. Its focus shall be to ensure that certain requirements for the companies participating in wholesale energy trading are in place in order to keep fraudster at bay and that all market participants are known to the regulators. Trading companies should demonstrate their technical, financial and organisational capacity

² “ERGEG and CESR advice to the European Commission in the context of the Third Energy Package - Record-keeping, transparency and exchange of information”, December 2008, Ref. C08-FIS-07-03, http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Cross-Sectoral/2008/C08-FIS-07-03_Recordkeeping_2008-12-17.pdf

to fulfil all energy regulatory requirements. On the other hand CEER does not recommend the regulatory access regime to attempt to check the companies' potential economic success. Finally it should be clarified that the scope focuses on regulatory issues whereas additional requirements for network access or starting trading activities related to TSOs or trading venues (such as energy exchanges) are not in the scope.

Implementation options

In the draft advice CEER discusses different possible options regarding the appropriate organisational framework which ensures the proper implementation of the requirements and standards listed above. The four options discussed in the draft advice comprise:

- to continue with the status quo and not introduce any changes;
- to extend the existing MiFID (Markets in Financial Instruments Directive) passport to electricity and gas trading;
- to set certain minimum and maximum requirements for national licensing regimes;
- to introduce a Europe-wide Energy Wholesale Trading Passport.

The options were evaluated (summary in the table below) against the background that a future regime should ensure a level playing field for market participants, provide an appropriate level of checks, identify all market participants and avoid unnecessary bureaucracy.

Based on those criteria, CEER concludes that a Europe-wide Energy Wholesale Trading Passport would be the best policy option to fulfil all goals. All other options do have deficits in one or the other dimension. The big benefit of the Europe-wide Energy Wholesale Trading Passport is that each trading company would need to apply for such a passport only once in one EU Member State and could then use this passport in all European wholesale energy markets. It is recommended that the national regulatory authorities are the entities issuing the passport and monitor legal compliance by the passport holders. The Agency for the Cooperation of Energy Regulators (ACER) could compile a comprehensive database with all trading companies active at European level. The national regulatory authorities would deliver the respective information to ACER. In order to ensure a level playing field application and supervision procedures should be standardised Europe-wide. Furthermore effective collaboration procedures between the home regulatory authorities of the passport holder and national regulatory authorities in the Member States where passport holders might also be active should be installed – especially concerning prosecution and enforcement in case of breaches.

Summary of the evaluation of the implementation options for a regulatory access regime to wholesale energy trading

	Continue with status quo	MiFID extension	Max/Min requirements	Europe-wide Energy Wholesale Trading Passport
Level playing field				
Appropriate level of checks				
Identify all market participants				
Avoid unnecessary bureaucracy				

Source: CEER evaluation

Requirements, non-requirements and administrative standards

Along the above mentioned lines CEER proposes the following requirements and administrative standards for a wholesale energy market access regime:

- All trading companies active in the market, including some basic information as the name of the company, field of activity and the ultimate ownership, should be known;
- Persons effectively running the trading company (management) should be obliged to provide certain information as for example their criminal record;
- If there is a fee for obtaining a trading license this should be cost-based;
- The maximum duration of the application procedure and the application procedure itself should be Europe-wide standardised;
- Trading companies should demonstrate their technical, financial and organisational capacity to fulfil all energy regulatory guidelines.

Not to be required shall be any provisions related to security of supply, specifying or requesting collaterals, checking the potential economic success of applicants or requiring the existence of a branch office in host countries outside the state which has issued the trading passport.

1 Introduction

1.1 Background

Wholesale energy markets are those elements in the electricity and gas market value chain, which made most progress in the degree of liberalisation and market integration over the last years. As prices established on wholesale markets serve as a benchmark for end-consumer retail prices, it is necessary to preserve the integrity of these markets. Only a proper functioning and competitive wholesale market may assure that also end-consumers benefit from it.

One main indicator for the performance of wholesale markets is market liquidity, which can – amongst others – be measured by the number of active market participants. The EU electricity and gas markets show a diverse picture regarding the participation in wholesale markets. Whereas for some markets the participation is widespread, others suffer under a lack of active trading companies and liquidity. These differences are most likely the result of a variety of influencing factors. Such factors among others may be formal or organisational requirements to be fulfilled for participating in a market. These requirements can be linked to:

- the governmental authorisation as a wholesale trading company;
- regulatory requirements for wholesale trading activities;
- access to the national transmission grid required for trading companies to conclude physical transactions and necessary (network, balancing, etc.) agreements;
- rules to become a member at an exchange.

The 3rd Package calls for the creation of a single European market and also the ERGEG Regional Initiatives³ have the objective to harmonise national electricity and gas markets and to pave the way to a Single European Energy Market. The European Council (at its meeting on 4 February 2011) reiterated this objective and called for a full integration of energy markets by 2014⁴. This can first and foremost be achieved for wholesale markets.

One element for achieving a Single European Market for electricity as well as for gas is to enable trading companies in the whole European Community to have easy access to trade in every national electricity and gas market. This trading access would not change or replace any domestic licensing requirements for networks access, physical supply and shipping, or balancing, but would facilitate energy trading across the internal market. These more organisational and technical issues shall be addressed via forthcoming framework guidelines and network codes for creating a level playing field.

Neither the 3rd Package, nor the Regional Initiatives address so far how to create a framework which provides for a proper regulatory wholesale market access process. Such a process needs to consider market integration objectives of wholesale markets and thus also aim for the creation of a level playing field for regulatory aspects.

³ For more information: http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_INITIATIVES

⁴ http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/119141.pdf

1.2 The process to date

CEER focused since 2009 on the issue of wholesale market trading access and different forms of licensing. An external study was commissioned in 2009 and finalised in autumn 2010. When tendering the study an exchange of views with market participants took place on the potential scope. The study was conducted by Brattle and Skadden Arps (the Consultants) and provides advice on whether a single and EU-wide binding passport for wholesale trading in electricity and gas is useful for defining appropriate and justified requirements for market participants to comply with and to reduce barriers for trading⁵.

The study explored the status quo in several Member States with the support from national energy regulators and market participants. This overview resulted in a distinction explaining whether existing licensing requirements are actually related to a potential market failure and thus justified or whether they do not seem to be related to any shortcomings and thus considered unjustified. Based on this analysis the Consultants derived proposals for a future energy trading licensing regime.

In the course of the study a further meeting with representatives of the European Federation of Energy Traders (EFET) was held, and preliminary results were presented. EFET members commented on the status of the study and provided valuable insight in practical licensing and trading issues.

Furthermore, a potential preliminary design of the trading licence was presented at the last Florence Forum (December 2010), which welcomed these initial ideas.

1.3 Objectives of the policy advice

The following policy advice proposes a framework for dealing with the existing shortcomings regarding regulatory access to trading on electricity and gas wholesale markets. The goal is to provide recommendations on whether harmonisation of wholesale market trading access is needed and if yes, what would be the best instruments to achieve it. Potential justified requirements and options for implementation serve as a basis.

Such recommendations may support policy makers at EU and national level to make informed decisions on next steps.

⁵ “Wholesale energy trading licenses in the EU”, Brattle Group/ Skadden, Arps, Slate, Meagher, & Flom UK LLP, 21 October 2010, http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Cross-Sectoral/2010/Brattle-Skadden%20Study%20Licensing%2021%20Oct%202010.pdf

CEER considers a number of relevant objectives, against which different options for solutions should be evaluated:

- A level playing field for market participants in wholesale energy trading shall be ensured. If strongly diverging access requirements across different markets were maintained there may be negative impacts on market integration. This would clearly endanger achieving the objective of having a single European electricity and gas market till 2014.
- An appropriate level of checks before entering the market shall be performed and regulators should be provided with a tool to enforce the legal rules. This shall be seen in combination with potential ongoing market monitoring activities (REMIT).
- Market monitoring activities must be supported or enabled by any regime for access to wholesale energy markets. The currently discussed REMIT proposal foresees reporting obligations for market participants. A wholesale market access regime must have the purpose to identify market participants who are falling under these obligations.
- Unnecessary barriers to market entry shall be avoided. Bureaucratic processes shall be kept at the level needed for appropriate checks. This may increase market efficiency by avoiding market entry costs and facilitate liquidity.

1.4 Questions for Public Consultation

European Energy Regulators are seeking stakeholders' feedback on the draft CEER Advice on the introduction of a Europe-wide Energy Wholesale Trading Passport and invite stakeholders to provide comments to this consultation paper. Responses to any aspect of the advice are welcome.

European Energy Regulators welcome responses on any aspect of our advice on the introduction of a Europe-wide Energy Wholesale Trading Passport.

In addition to inviting relevant stakeholders and market participants to respond generally to this consultation and participate in the discussions on this document, CEER seeks the opinion of the respondents on a number of specific issues related to the scope and options set out in our advice. Details to the issues addressed in the questions are highlighted in the relevant chapters.

Stakeholders are therefore invited to reply and provide comments on the following non-exhaustive list of 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?

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

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?

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

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)?

Question 5:

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

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

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.

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

2 Analysis of existing regimes

2.1 Wholesale energy trading licensing regimes in the EU Member States

In Europe there is currently a huge variety of different rules and regimes applying to trading companies for access to energy markets. In some countries trading companies are faced with far reaching duties and costs in order to be able to trade. The study conducted by Brattle and Skadden Arps analysed in detail the licensing regimes in the following Member States, providing a representative overview of the remaining EU markets⁶:

- Germany;
- Czech Republic;
- Hungary;
- UK;
- Spain (new and previous regime);
- Norway.

The analysis relied on documents available in the public domain and interviews with representatives of approximately 20 active trading companies. The outcome underlines the diversity of the different national procedures, causing high costs for trading companies active in different national markets and could pose a barrier to market entry. Whereas the detailed descriptions can be found in the study directly⁷, the main differences and impediments for wholesale market participation should be highlighted here:

- The requirement of a branch office in the respective country;
- License fees, which may be costly for trading companies in some countries;
- High collateral requirements, high bureaucratic cost for obtaining a trading license (also indirect costs such as translations etc.);
- Lengthy processes until a license is issued and a market participant may become active.

Moreover market participants have to approach different types of authorities in different countries/markets in order to be able to start trading activities. Furthermore, several different reporting obligations (on ongoing business activities) may lead to additional tasks and additional costs.

⁶ “Wholesale energy trading licenses in the EU”, Brattle Group/ Skadden, Arps, Slate, Meagher, & Flom UK LLP, 21 October 2010, http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Cross-Sectoral/2010/Brattle-Skadden%20Study%20Licensing%2021%20Oct%202010.pdf

⁷ See footnote 4.

Another survey on the existence of licensing regimes involving 22 CEER members showed that the need to obtain a license depends on the intended business activities (electricity or gas, physical or financial trade, wholesale market or supply of end-consumers). For electricity trading several of the EU Member States require a “classical” license, however in the remaining countries similar processes may still exist. For gas fewer countries do require such procedures. As there are countries with no regulatory access requirements at all it should be noted that in those markets a consistent overview on who is actually acting on the market is missing. Accordingly, there are no measures to limit market access to “fit and proper” trading participants.

Existing processes are mainly based on national laws, as current EU energy legislation does not provide any provisions for wholesale market trading access regime. The parallel existence of high access requirements in some countries and no requirements at all in others results in an unlevelled playing field, (unjustified) barriers to market entry and therefore presents an obstacle for the creation of a Single European Energy Market.

In addition to these points there are other drawbacks of having inconsistent regimes in the different Member States. Up to now there are, at least at European level, certain regulatory gaps in the surveillance of energy markets. The European Commission adopted a legislative proposal in order to tackle these problems (Regulation on Energy Market Integrity and Transparency, REMIT) and proposed it to the Council and the Parliament. To know all trading companies active on European energy markets is a prerequisite for effective monitoring of the wholesale market and for implementing this regulation in the future. For this purpose a consistent access regime of all trading companies will be needed.

2.2 European level financial legislation – MiFID Passport

There is an example for an EU market access regime in EU financial legislation. Under the Markets in Financial Instruments Directive (MiFID)⁸ a single passport mechanism has been established through the MiFID licensing regime which could be an example for further considerations in the energy market.

It should be noted that MiFID is currently reviewed and the Commission *inter alia* proposes to narrow the MiFID exemptions, which would significantly limit or even abolish the scope of the MiFID exemptions for commodity firms. This would have the effect that most energy trading companies would have to apply for a license for investment services under MiFID and would therefore be treated like investment firms under the financial market regulatory framework, including the necessity to fulfil the minimum financial standards (capital) of the Capital Adequacy Directive (CAD)⁹, and would fall under the supervision of securities regulators.

Companies falling within the scope of MiFID are usually undertakings active in investment services on a professional basis (e.g. performance of investment services or activities through trading financial instruments – also related to energy). However there are a number

⁸ Markets in Financial Instruments Directive 2004/39/EC, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004L0039:EN:HTML>

⁹ Directive 2006/49/EC of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:177:0201:0201:EN:PDF>

of MiFID exemptions, which cannot be discussed in detail in this document. Nevertheless it should be noted that the characteristics of wholesale energy products have resulted in a situation where some energy trading companies, in the last years, decided to obtain licenses under MiFID to benefit from its EU passport function. However as there is no clear (legally defined) interface between financial and energy trading there remains room for interpretation and uncertainty.

This is partly caused by the fact that MiFID covers a number of energy wholesale products whereas it provides for exemptions from the licensing requirements benefiting particularly energy companies.

The MiFID licensing provisions do establish requirements regarding the management of the applicant companies, its ownership, the company structure and organisation, regulatory compliance and sufficient capital. The main requirements regarding the management representatives are their reputation (no criminal records) and professional experience. Moreover, regulatory requirements (compliance) need to be met and the organisational structure needs to have adequate resources and functioning internal procedures. The applicant has to provide all information necessary, including a programme of operations setting out *inter alia* the types of business envisaged and the organisational structure. For the company, minimum financial standards (capital) need to be fulfilled in accordance with the Capital Adequacy Directive (CAD).

This short summary of requirements shows that the MiFID license does not check or guarantee whether an applicant will become an economically successful market participant. Moreover it indicates that the requirements defined may be difficult to be assessed. Especially company resources or internal business processes may be shown on paper in the course of the licensing process, without the guarantee that they will be followed in the daily business operations.

The responsible entity for granting a MiFID license and regulating a licensed firm is the “home-state” securities regulator. A market participant can expand his activities across the European Economic Area (EEA) by notifying the “host-state” securities regulator. This simple passport principle ensures that companies do need to go through the entire procedure only once. In that sense the MiFID passport could be an example for any future energy regime.

3 Scoping, requirements and administrative standards of a wholesale energy market access regime

Chapter 2 of this document has shown that the access requirements to wholesale energy markets do differ because of a patchwork of individual national licensing regimes. These regimes do not provide a comprehensive oversight regime and might hinder the efficient implementation of the supervision. It also poses administrative burdens and barriers to competition in the wholesale energy markets. Several of the current trading licensing requirements in European countries are perceived as serious market entry barriers especially for trading companies that want to be active in several countries. A question that has been posed by stakeholders is: Why do not we abolish wholesale trading licenses in the European Union? From their point of view, this would significantly reduce costs for trading companies. The key topic of this chapter therefore is to determine the necessity and the scope of a wholesale energy market access regime. Are there valuable reasons why to derogate from the principle of free movement of goods and services and is the resulting requirement proportionate in relation to the purpose of the measure? Possible regulation of access must be based on objective, non-discriminatory criteria so that it is not used arbitrarily. The procedure should not be such as to deter the companies concerned from pursuing their business. Following the European legal principals the proportionality and efficiency of the measures have to be set in contrast to the effects. The measure shall keep the bureaucratic burdens as low as possible and check the efficiency of the options in contrast to alternatives. The topics discussed subsequently are:

- Law enforcement challenge;
- Necessity and degree of quality checks for potential market participants;
- Administrative standards.

3.1 Challenges in law enforcement

One function for a regulatory access to trading on electricity and gas wholesale markets – often advocated – is directed towards the challenge to minimise the ability of companies to evade law enforcement. At most basic level, the regulators have to know all market participants to execute their supervisory function efficiently and effectively towards the supervised entities. This includes basic details of each trading company participating in wholesale electricity and gas trading, information on the field of activity of the company (electricity or gas trading or both), if the company is only active in energy trading or also in energy supply and whether the energy sector is their exclusive field of activity or whether they are also active on other (e.g. financial, other commodities) markets. In addition, trading firms should also declare in which countries they are active. In case a trading company intends to be active in various countries the company would need to specify their fields of activity for each of these countries. The existing national regimes in Europe differ strongly. In several countries a registration is not requested and the MiFID passport captures only a small share of energy trading companies so that an overview with the above mentioned features does currently not exist in Europe. A revised regulatory access to trading on electricity and gas wholesale energy markets should establish such a record.

A second requirement often based on the argument of law enforcement is the requirement to open up a branch office in the country of activity. This is the case in several European countries. Regulators argue that trading companies might attempt to avoid the jurisdiction of the host country by establishing their headquarters outside of the country. By keeping assets outside of the country or choosing a home jurisdiction whose laws prevent the disclosure of information, the trading companies could seek to escape liability for fines or adverse judgments. The argument might be applicable as far as no collaboration agreement between host and home countries exist. However, within the EEA, energy regulators have strong concerns regarding the necessity and legality of this requirement as detailed legal and administrative rules for cooperation exist or can be defined. The requirement rather seems to pose a major impediment to entering a new market as it entails both one-off set-up and ongoing costs associated with reporting, accounting and transfer pricing.

Regulators conclude that a regulatory access to electricity and gas wholesale markets should require a registration of companies to ensure that the regulator knows all market participants. Requiring a presence in at least one EEA Member State is sufficient to minimise law enforcement challenges as well as to ensure that developed rules for legal and administrative cooperation exist. It would obviate the need for a second jurisdiction to impose any additional presence requirements. Energy regulators recommend that future legislation should foresee a prohibition for Member States to require additional branch offices.

3.2 Necessity and degree of checks for potential market participants

Wholesale electricity and gas trading markets are relatively young. Trust in the market and its reliability is highly important to secure the integrity of the markets. A function of a regulatory access to electricity and gas wholesale markets could be to provide a standard for checking market participants becoming active in the market. At the same time checks shall not overburden supervising authorities. The focus shall be on providing guards against criminals and fraudster to enter the market. The European greenhouse gas emission trading market has shown that fraudsters and criminal subjects can cause tremendous damages. In MiFID and national licensing regimes different requirements are set. What degree of screening is recommended?

3.2.1 Basic capability and liability check

Firstly, before allowing companies to participate in the market, a requirement might encompass that trading companies show that their technical and organisational capacity is sufficient and that they fulfil all energy regulatory guidelines. This includes e.g. that trading companies should be aware of their reporting requirements and should be technically and organisationally able to fulfil them. Secondly, the regulatory access to electricity and gas wholesale markets supplemented by an oversight regime should provide for the possibility that irresponsible or criminal traders can be identified and thus either prevented or excluded from the market. The degree of detail of the checks remains to be determined. Some lessons can be drawn from the UK financial regulator's 'fit and proper person' test, presented in the Brattle/Skadden study¹⁰. The 'fit and proper person' test is a standard which combines both

¹⁰ See pages 48-49 of the Brattle/Skadden study on "Wholesale energy trading licenses in the EU", Brattle Group/Skadden, Arps, Slate, Meagher, & Flom UK LLP, 21 October 2010, http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Cross-Sectoral/2010/Brattle-Skadden%20Study%20Licensing%2021%20Oct%202010.pdf

objective and subjective elements to provide a regulator the flexibility to determine whether a particular (legal) person should be allowed to participate in particular markets under the relevant circumstances. For the regulatory access to trading on electricity and gas wholesale energy markets, the checks should be organised in a practicable way, especially for smaller regulatory authorities. European energy regulators recommend focusing checks on the persons effectively directing the company and to require the applicants to include statements that the personnel involved in trading has not been convicted on criminal offences, offences of dishonesty fraud or financial crime or any other adverse findings that disqualifies them from participating in the wholesale energy trading. Information about changes relevant for the license has to be submitted by the company to the home regulator. Missing and false statements would have consequences; in the last stage the access permission could be revoked.

3.2.2 Economic success check

Some regulatory regimes foresee detailed requirements in the sense of making sure that not only the trading companies' but also the traders will be successful in the market. This includes quality checks such as trading exams, a presentation of a business plan, proof of the success of the trader's activity or any other requirements related to the competence of the applicant's staff. Such requirements are perceived as problematic not only because they might be ineffective but in addition they might impose an administrative burden on the applicant that could dissuade market entry. Companies have an own interest to avoid incompetent managers because they will suffer if the managers fail. Energy trading companies themselves are already highly incentivised to trade successfully, since they will lose their investment in the company if they fail. At the same time it is highly doubtful that any requirement at the time of the license application would be successful in screening out candidates that are likely to fail in the market at some point in the near future. Furthermore, there are other private institutions (such as energy exchanges) closer to business to organise relevant exams. A regulatory access to trading on electricity and gas wholesale energy markets should neither double those know-your-customer-checks nor substitute them.

3.2.3 Collaterals – Systemic risk minimisation

A topic that is especially under discussion in the reforms of the financial market framework is the concern that an under-collateralised energy trader might become 'too big to fail' and its rescue might require public funds. A regulatory access to trading on electricity and gas wholesale energy markets could potentially be a tool to specify collateral amounts.

Although insolvency is recognised as a threat, energy regulators hesitate to recommend the regulatory access regime to specify the collateral amounts. Firstly, it is perceived to be more effective to place responsibility for checking collateral requirements on a party who has a direct interest in the quality of the checking procedure. A counter party has a direct interest in a trader having sufficient collateral to cover a trade, because it is the counterparty that would suffer if the trader went bankrupt. Organised exchanges and in particular clearing houses have sophisticated rules regarding the posting of collateral and credit. In contrast, a regulator or Ministry has a less direct interest in these issues, and therefore has a weaker incentive to carry out effective checks, or even to know which the most appropriate checks to perform are. Secondly, different parties have different collateral requirements. Whereas a counter party will generally be interested in collateral that covers the margin on outstanding trading position, TSOs are concerned that network users behave responsibly and have sufficient collateral to cover any imbalance costs in the event of bankruptcy. Putting collateral requirements in a trading license would also impose standards on non-standard products traded OTC. Regulators fear that it will be difficult to define adequate requirements in an

access regime which would be static and hardly related to the reality of a trading world where collateral requirements are highly dynamic. In sum, existing institutions and trading arrangements are a better mechanism for setting collateral requirements than a regulatory access to trading on electricity and gas wholesale energy markets.

3.2.4 Coverage of supply security aspects

Another possible question concerning the scope of a regulatory access to trading on electricity and gas wholesale energy markets is whether it should also cover supply aspects. In several countries wholesale and supply licenses are combined. System security could be threatened by unexpected imbalances – for example a trader failing to deliver a large volume of electricity or gas which could make it difficult for the TSO to balance the system. We might want to block those ‘irresponsible’ parties from the market and protect consumers by laying down minimum standards of behaviour. Requirements might be set e.g. to prove to source gas from several diverse sources or to sign the grid code.

European energy regulators agree that the requirements might be relevant for supply purposes but they do not apply to all firms active in wholesale energy trading. For example companies involved in pure financial trading and trading in derivatives will not threaten security of supply, since these trades are settled far in advance of delivery or do not involve physical settlement at all. Signing grid codes makes only sense in case of an intention to physically deliver electricity or gas. Given that trading companies will in any case sign up to the grid code, it should not be required as a condition for obtaining a wholesale energy trading license. Doing so could unnecessarily lengthen the time required to obtain a license. Energy regulators recommend a clear separation of wholesale energy trading and supply licenses. The security of supply aspects should be handled in network use agreements or supply licenses in case the company is involved in physical delivery.

3.3 Administrative standards

Another source of potential discrimination and exaggerated market entry barrier might result from missing or disadvantageous administrative standards. The administrative standards will strongly depend on the way a new regulatory access to trading on electricity and gas wholesale energy markets regime is implemented (discussed in Chapter 4) but some basic lessons can be drawn based on the current regimes.

3.3.1 Fees

The consultants have identified in their study two types of charging philosophies for licenses – ‘cost-based’ vs. ‘turn-over or revenue-based’ approaches.¹¹ Cost-based licenses are designed to either cover the cost of issuing the license, or else the cost of the energy regulator. Revenue-based license regimes apply a fee according to a trader’s turnover, and act in a similar way to a tax. Experiences in some European countries show that exaggerated fees might act as a serious market entrance barrier for trading companies. Even though it is generally comprehensible that trading companies should bear the cost they provoke, fees

¹¹ See in “Wholesale energy trading licenses in the EU”, Brattle Group/ Skadden, Arps, Slate, Meagher, & Flom UK LLP, 21 October 2010, http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Cross-Sectoral/2010/Brattle-Skadden%20Study%20Licensing%2021%20Oct%202010.pdf

should not exceed these costs. Therefore, a fee for obtaining a trading license should be cost-based.

3.3.2 Application processing standards

The study showed that application processing for a trading passport has a strong potential to act as market entry barrier and to discriminate between applicants.¹² Extensive checks by the responsible regulatory authority should be committed to processing applications within an adequate period of time.

The maximum duration of the application procedure and the procedures themselves should therefore be Europe-wide standardised. This would also allow that the trading passport is valid in all EEA countries once issued, which would significantly reduce bureaucratic cost (see option on a Europe-wide Energy Wholesale Trading Passport in Chapter 4.4).

3.3.3 Fines and Infringement

In case of infringement of the requirements and obligations, regulatory authorities should have the ability to impose sanctions. The revocation of a trading passport could only be seen as a last resort in case of severe breaches. To appeal a revocation or fines should be possible at a dedicated court. Procedures shall be harmonised to avoid non-harmonised behaviour of supervising authorities. Effective collaboration procedures between the home and the host regulator should be in place.

3.3.4 Language

The study has shown that the communication between the licensee and the licensing authority has often to be done in the local language¹³. This is no problem for the companies in their home countries but for foreign companies it is referred to as a source of barrier to market entry and could generate high costs especially if a trading company is active in several countries. Therefore, energy regulators consider it useful that a new regulatory access to electricity and gas wholesale markets regime takes this aspect into consideration.

3.4 Recommendations concerning scoping, requirements and administrative standards of a wholesale energy market trading access regime

European energy regulators conclude that in general, there are objective reasons for a regulatory access regime to trading on electricity and gas wholesale markets. Its focus shall be to ensure that all market participants are known to the regulators and minimum quality requirements for the companies participating in wholesale energy trading are in place in order to keep fraudster at bay. It should not attempt to check the companies' potential economic success.

¹² See footnote 9.

¹³ See page 15 of the study on "Wholesale energy trading licenses in the EU", Brattle Group/ Skadden, Arps, Slate, Meagher, & Flom UK LLP, 21 October 2010, http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Cross-Sectoral/2010/Brattle-Skadden%20Study%20Licensing%2021%20Oct%202010.pdf

3.4.1 Requirements

Based on the above reasoning, European energy regulators recommend that a wholesale energy market access regime shall require:

- To establish a record of who is active in the market. This shall include basic details on the company, a list of persons who effectively direct the business, fields of activity, as well as information in which countries the trader will be active.
- To require applicants to prove that the people effectively directing the firm and the firm are able to carry out their compliance duties, guard against fraudulent behaviour. Thus applicants should be obliged:
 - to prove that the people effectively directing the company have not been convicted on criminal offences, offences of dishonesty fraud or financial crime or any other adverse findings that disqualifies them from participating in the wholesale energy trading. They also should provide a statement that also none of the personnel directly involved in trading is subject to any of the above mentioned cases;
 - to have adequate systems and controls to undertake such transactions as an ongoing business;
 - to show to be organised so that it may adequately fulfil the regulatory requirements mandated by the relevant authority and any other relevant statutory or regulatory obligations;
 - to agree that it will not engage in, or aid or abet, any conduct which may have the effect of disrupting, manipulating the supply, price or transactions in electricity or gas; or which may have the effect of creating a misleading impression as to the present or future demand for or price of wholesale electricity or gas (“good behaviour clause”) as required by REMIT.

3.4.2 Non-Requirements

European energy regulators recommend that a regulatory access regime to trading on electricity and gas wholesale energy markets shall not require:

- To fulfil requirements related to supply security. It is clearly requested to separate wholesale energy trading from supply licenses.
- To provide inappropriate proofs of the quality of the company, especially like:
 - To demonstrate that the employees of the firm are skilled at trading (trading exams);
 - To decide whether to issue trading licenses based on the expected profitability of the applicant, e.g. requirement to present a business plan;

- To demonstrate a minimum level of capitalisation or post any collateral requirements.
- To establish a branch office in the country – such a requirement is in any case contrary to European law.

3.4.3 Administrative standards

European energy regulators recommend that the responsible regulatory authorities should obey certain administrative standards for the assignment of a trading passport and the supervision of the licensee in order to minimise bureaucratic cost and potential discrimination. These administrative standards should include:

- Passport fees should be cost-based;
- Sanctions should be foreseen in case of infringement of passport requirements; the revocation of a trading passport should only be seen as a last resort. Appeals to a revocation should be possible e.g. at a dedicated court or other institution;
- The maximum duration of the application procedure and the procedures themselves should be Europe-wide standardised;

4 Evaluation of options

In the chapters above, the basic cornerstones of a regulatory access to trading on electricity and gas wholesale energy markets were developed. As described in Chapter 1.3 such a regime should ensure a level playing field for market participants, provide an appropriate level of checks, identify all market participants and avoid unnecessary bureaucracy.

In the following, different possible options will be analysed in order to identify the appropriate organisational framework which ensures the proper implementation of these cornerstones.

4.1 Continue with the status quo

Chapter 2 provided an analysis of the current national systems. In the current system there is no European level harmonisation of the requirements to participate in the wholesale energy market. While there are some Member States with no access restriction at all, there are others with considerable burdens for market access. This inconsistency is one of the major obstacles on the way to a level playing field for all market participants – especially as a convergence of the different national regimes could not be observed in the past. Furthermore, as there are Member States with no licensing regime at all, not all market participants can be identified and an appropriate level of checks cannot be guaranteed. As trading licenses are generally only valid in one country, the status quo leads to high bureaucratic burdens especially for trading companies active in several Member States.

Against the background of these findings there is apparently a need for action. To keep the current system is no valuable option for reaching the above mentioned goals.

4.2 Extension of MiFID passport to electricity and gas trading

As already outlined in Chapter 2.2 the “Markets in Financial Instruments Directive” (MiFID) contains a passport license model. There are some energy trading companies in Europe holding a MiFID passport. Nevertheless, so far most energy trading companies are not required to obtain such a passport. In order to have a Europe-wide standardised approach the coverage of the MiFID passport could be extended to all companies trading on the wholesale energy market. The MiFID licensing regime is currently under revision. However any extension of the MiFID license – as currently on table – will only partly cover the wholesale energy market. Thus, it is not useful as it would imply some serious disadvantages for the respective companies in the energy markets¹⁴ and would still not cover companies trading purely physical products. The MiFID license and the respective requirements are designed for investment services and tend to guarantee consumer protection in investment services. Moreover, to extend the scope of the license to the wholesale energy market would mean additional requirements (such as proof of experience or capital requirements), causing unnecessary additional costs and bureaucratic burdens to the respective trading companies. Furthermore, counterparties on wholesale level are professional market participants; private customers needing special protection do not participate on the wholesale energy market (which differs from the scope of MiFID). Against this background, the application of MiFID requirements would not be appropriate for the energy wholesale markets.

4.3 National licensing regimes with a set up of minimum and maximum requirements

An option to achieve a certain level of harmonisation between Member States would be a continuation of national licenses constrained by a set of minimum and maximum requirements. Such an approach would be an improvement compared to the current situation. Exaggerated burdens for entering the market could be avoided while at the same time a certain level of appropriate checks could be ensured and at least a more level playing field for the energy wholesale market could be reached. Situations where market participants are unknown to the national regulatory authorities could be avoided by setting the adequate requirements.

Nevertheless, energy trading companies active in several Member States would still need to apply for a license in each market. Even though bureaucratic burden in some Member State might decrease the fact that trading companies need to apply for several licenses would still imply significant bureaucratic costs. Furthermore, it has to be taken into account that this option would lead to the introduction of licenses also in those Member States that have no licensing regimes so far. Overall, this would lead to a huge increase in bureaucracy and costs for trading companies.

¹⁴ European Energy Regulators’ response to the European Commission’s consultation on the MiFID review, Ref. C11-FIS-23-04, 2 February 2011, http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Cross-Sectoral/2011/C11-FIS-23-04_MiFID_02-Feb-2011.pdf

There would be a need for a Europe-wide legal basis to implement such minimum and maximum level of requirements. As a second step there would be a need to implement the European requirements in national law.

4.4 Europe-wide Energy Wholesale Trading Passport

Regulatory access to trading on wholesale energy markets could also be granted by a Europe-wide Energy Wholesale Trading Passport. Such a trading passport would be issued at Member State level by national regulatory authorities. Each trading company would need to apply for such a passport only once and could then use this passport on all European wholesale energy markets. When issuing the passport, all national regulatory authorities would be limited to the general requirements developed in Chapter 3 (with a more detailed specification and approach in order to ensure a level playing field). In order to get a comprehensive overview over all market participants, national regulatory authorities would inform ACER on all applications for a trading passport. This way ACER could provide an overview on all trading companies active in Europe. Furthermore, ACER could also provide a list with trading companies whose application was rejected. This way it could be avoided that companies try several times to get a passport.

There are different options for implementing the trading passport into law, preferable it should be a Regulation to ensure harmonised requirements. A fast option would be to include such a trading passport as an additional article of the currently discussed Regulation on Energy Market Integrity and Transparency (REMIT).

With only one passport valid for all EU Member States, burdens for entering the energy trading market would be significantly reduced. Trading firms would not need to apply several times for access permission. This would ensure a level playing field for market participants and lower bureaucratic costs at the same time. Also those Member States who had no access requirements to trading on wholesale energy markets so far would need to introduce the Europe-wide Energy Wholesale Trading Passport. Nevertheless, this does not lead to additional bureaucracy for trading companies active in more than one Member State (for these companies it will mean less bureaucracy).

4.5 Conclusion on the implementation options

The analysis of different possibilities shows that most options for the implementation of a wholesale energy market access regime do not meet the necessary basic objectives. The following table provides a brief overview of the different options and the necessary objectives which are to be met:

	4.1 Continue with status quo	4.2 MiFID extension	4.3 Max/Min requirements	4.4 Europe-wide Energy Wholesale Trading Passport
Level playing field				
Appropriate level of checks				
Identify all market participants				
Avoid unnecessary bureaucracy				

Not to change anything is clearly not an option as the current system does not meet any of these objectives. The extension of the existing MiFID trading license would hardly cover companies trading physical products and the MiFID requirements seem to be too restrictive for energy wholesale trading. The implementation of minimum and maximum requirements would ensure the integrity of the market and could provide an overview of the markets and the participants but would lead to additional restrictions in market access.

The introduction of a Europe-wide Energy Wholesale Trading Passport appears to be the most proper solution. Such an approach would ensure transparency and integrity and would lower the market entry barriers at the same time. As there are several trading companies already holding a license under MiFID there should not be an obligation to apply additionally for a trading passport. In order to keep bureaucracy low, each trader should be covered either by MiFID or by the trading passport.

5 Recommendations

Today there are very different forms of wholesale market access throughout Europe. The supervision of the wholesale energy market currently consists of a patchwork of individual national licensing regimes. CEER recognises that this poses serious administrative burdens and barriers for competition in the wholesale energy markets. Several of the current licensing requirements in European countries are perceived as serious market entry barriers especially for trading companies that want to be active in several countries. Furthermore, as there are countries with no access requirements, it should be noted that in those markets a consistent overview on who is actually acting on the market is missing.

Based on these findings, CEER recommends certain requirements and administrative standards for a wholesale energy market access regime:

- All trading companies active on the market, including some basic information as the name of the company, field of activity and the ultimate ownership, should be known;
- Persons effectively running the trading company (management) should be obliged to provide certain information, for example their criminal record;
- If there is a fee for obtaining a trading license this should be cost-based;
- The maximum duration of the application procedure and the application procedure itself should be Europe-wide standardised;
- Trading companies should demonstrate their technical, financial and organisational capacity to fulfil all energy regulatory guidelines;
- A branch office, collateral amounts, an economic success check or any provisions relating to security of supply should not be required.

There are generally different options of how to implement the above mentioned requirements. CEER recommends ensuring certain basic principles while choosing the implementation option. A future regime should ensure a level playing field for market participants, provide an appropriate level of checks, identify all market participants, avoid unnecessary bureaucracy and ensure effective enforcement capability.

CEER believes that a Europe-wide Energy Wholesale Trading Passport is the most appropriate way to implement the necessary requirements and administrative standards. Such a passport should be issued at Member State level by national regulatory authorities. Each trading company would need to apply for such a passport only once and could then use this passport on all European wholesale energy markets. The Agency could compile a comprehensive database with all trading companies active at European level. National regulatory authorities would deliver the respective information to the Agency. At the same time all regulators agree that the objective of achieving an effective collaboration procedure regarding the host regulator should be fulfilled – especially concerning prosecution and enforcement in case of breaches.

With only one passport valid for all EU Member States, burdens for entering the energy trading market would be significantly reduced. Trading firms would not need to apply several times for access permission. This would ensure a level playing field for market participants and lower bureaucratic costs at the same time.

Annex 1 – CEER

In 2000, ten national energy regulatory authorities signed the "Memorandum of Understanding for the establishment of the Council of European Energy Regulators" (CEER). They had voluntarily formed the council to facilitate cooperation in their common interests for the promotion of the internal electricity and gas market. In order to cope with a growing number of issues and to improve cooperation at the operational level, the regulators decided in 2003 to formally establish themselves as a not-for-profit association under Belgian law and to set up a small secretariat in Brussels. The Statutes (English version, Statutes amendment) were published in the annex of the Belgian State Gazette on October 21st, 2003. The CEER now has 29 members - the energy regulators from the 27 EU-Member States plus Iceland and Norway.

The work of CEER is structured according to a number of working groups, composed of staff members of the national energy regulatory authorities. These working groups deal with different topics, according to their members' fields of expertise.

This report was prepared by the Wholesale Market Supervision Task Force of the Financial Services Working Group.

Annex 2 – List of abbreviations

Term	Definition
ACER	Agency for the Cooperation of Energy Regulators
CAD	Capital Adequacy Directive (Directive 2006/49/EC)
CEER	Council of European Energy Regulators
CESR	Council of European Securities Regulators
EEA	European Economic Area
EFET	European Federation of Energy Traders
ERGEG	European Regulators' Group for Electricity and Gas
EU	European Union
GGP	Guidelines of Good Practice
MiFID	Markets in Financial Services Directive (Directive 2004/39/EC)
OTC	Over the counter
REMIT	Regulation on Energy Market Integrity and Transparency (proposal)
TSO	Transmission System Operator
VAT	Value added tax