Commodity Markets Council - Europe

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I. General observations

CMCE welcomes the European Commission proposal to review the REMIT framework. We understand the broader context of this initiative is related to the energy price crisis and specifically to the functioning of the EU electricity markets.

CMCE notes with concern, however, that some of the proposed changes appear to be driven by a desire to align the REMIT regime with elements of the financial market regulatory regimes under the Market Abuse Regulation (EU/596/2014) (**MAR**) and the Markets in Financial Instruments Regulation 2014/65/EU) (**MiFID2**) without either (a) an adequate assessment of the appropriateness of those measures for the European gas and power markets, or (b) a holistic consideration of how those elements operate within MAR and MiFID2.

It is vital to stress that physical gas and power markets are very different from financial (commodity derivatives) markets. They are characterised by the activity of many more and different entities, including small and medium sized physical suppliers acting at local or national level and energy consumers that procure gas/power to cover their own consumption and not for trading purposes.

We note, for example, the proposed changes which would increase the scope of the offences and obligations under REMIT, which are framed so as to align the prohibitions under REMIT with those under MAR. MAR, however, contains essential safeharbours[1], which are not found within REMIT. Similarly, the proposal to introduce new obligations derived from MiFID2 on all market participants (a) does not reflect the proportionate and limited application of the corresponding obligations under MiFID2[2], and (b) does not appear to have taken into account the need for market participants to use basic algorithms given the existence of multiple liquidity pools for wholesale energy products in the European markets.

The net effect of many of these proposed changes – as detailed further in this note – would be to widen the scope of REMIT, introducing new prohibitions and requirements which would go beyond the scope of the corresponding obligations under MAR and MiFID2. They also go further than comparables regimes in other significant regions (such as the US, which for example has no equivalent algorithmic trading requirements under the FERC regime).

[1] As, for example, reflected in Recitals (29) and (30) and article 9 of MAR.
[2] See, for example, article 1(5) of MiFID2.

We are concerned at the potential impact of these measures on liquidity in the European energy markets. Some of the proposals would also raise barriers to entry in the European energy markets, e.g. by increasing costs to the point of deterring some new entrants or and by imposing obligations on third country firms to "declare an office" in the Union. These proposals could risk reducing the number of market participants willing to engage in EU energy markets, reducing liquidity (and the availability of LNG import volumes) as a result, and could also lead to the migration of energy derivatives markets away from the EU. We therefore urge the Commission to reconsider these proposals in the light of these risks.

In our opinion, many other changes in the proposal go in the right direction, such as the newly introduced supervision of inside information Platforms and Registered Reporting Mechanisms, which market participants must use to comply with their REMIT obligations. We also welcome the proposal on the cooperation between Authorities, which mainly intends to reinforce the cooperation as well as data and information exchange between ACER, National Energy Regulatory Authorities (NRAs), ESMA and national financial market authorities. In our view, these measures are very much to be welcomed and will help to promote the soundness and integrity of the markets.

Finally, we note that the European Commission is not proposing to take measures to simplify the REMIT framework for reporting and disclosure of inside information such as harmonizing thresholds for the publication of inside information or the introduction of single sided reporting on organised marketplaces. We also note that, although there is much thought to the reporting of Inside Information, the Commission did not take the opportunity to increase the scope of Market Participants to ensure that System Operators, who have inside information, also have an obligation to report inside information and become Market Participants.

Our detailed comments below related to the provisions on the alignment of REMIT with the Market Abuse Regulation (MAR), algorithmic trading, the obligation for non-EU market participants to register an office in an EU Member State, the application and enforcement of the REMIT provisions and finally the provisions regarding transaction reporting and disclosure of inside information.

2. Detailed comments

Declaring an office in an EU Member State

CMCE Members are concerned at the introduction of a wholly new requirement under article 9(1) of REMIT on third country market participants to "declare an office in an EU Member State".

It is not made clear what "declaring an office" means or what legal, regulatory and tax consequences would follow from such a declaration. We are deeply concerned that the proposal could be taken, for example, as a mandatory branch establishment requirement.

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If so, it would likely have serious adverse consequences for third country market participants, who currently contribute liquidity and sell their production into the EU energy markets. In addition, there has been no consideration what this would mean for exchange traded commodity derivative contracts such as the TTF contract, which are traded by market participants around the world for example with LNG delivery exposure into the EU27 and could be harmful for security of supply of gas.

A requirement to register an office in an EU member state, for example, or to maintain a permanent local presence, could trigger local tax requirements, as well as corporate, regulatory, and other legal obligations under the relevant local law, increasing the overall costs for non-EU Market Participants creating more obstacles for the participation in the EU Wholesale Energy markets.

It is to be expected that for many third country firms the introduction of such a requirement would be prohibitive. A direct consequence of which could be the reduction of liquidity within the market, as a result of derivatives markets migrating to venues away from the EU. Thereby reducing the number of third country LNG sellers willing to sell their production into the EU.

Finally, we advocate that such a requirement is in any event superfluous, since third country market participants are already required to register with Member State regulators and provide their address as part of the registration process.

We also note that there are no transition periods provided for in the European Commission's proposed text, in order for market participants to arrange the required "office". This can take a considerable amount of time, certainly more than the current 20 days provided for in the Article on the entry into force of the Regulation.

We would strongly support the Parliament's proposed amendments and remove the requirement to declare an office in a Member State.

Alignment with the Market Abuse Regulation (MAR)

The European Commission proposes numerous changes to the REMIT definition of insider dealing and market abuse to align REMIT with corresponding elements of the MAR.

These proposals appear to be driven by a desire to align financial and energy regimes. It is not clear what specific benefit is derived from such an alignment – we consider, for example, that such alignment is not necessary to enable appropriate co-operation and information sharing between financial and energy market Authorities. We are concerned, also, at the increased potential for case-law and practice to develop under MAR in the financial markets in a way which leads to inappropriate interpretations and applications of REMIT in the energy markets, and vice versa.

However, we also note that the proposals in fact fail to create a true alignment between REMIT and MAR, because they do not take into account of other key differences between REMIT and MAR (such as the scope of the inside information definitions or the defences/exemptions under each regime).

Example

An example of this is the proposal to add a new point to the definition of "inside information" in the following terms:

"(e) information conveyed by a client or by other persons acting on the client's behalf and relating to the client's pending orders in wholesale energy products, which is of a precise nature, relating directly or indirectly, to one or more wholesale energy products…".

This appears to be intended to align the REMIT element of "inside information" with that under MAR, by introducing a limb equivalent to that under article 7(1)(d) of MAR. (It may also be intended to give legal force to footnote 52 in ACER's current REMIT Guidance.) There are, however, a number of issues with this:-

(a) First, article 7.1(d) clearly relates to the front-running of orders for execution by a broker (a person "charged with the execution of orders"). The proposed REMIT limb contains no reference to persons "charged with the execution of orders" and, as such, could apply bids and offers communicated between market participants in the normal course of negotiating bilateral trades. As such, it makes it very difficult for market participants to negotiate trades with each other, and would have a chilling effect on liquidity,

(b) Second, it would undermine the reliability of ACER's crucial guidance on the meaning of "information" as set out in Section 3.2 of its current REMIT Guidance. At page 33 of that Guidance, ACER clarifies the concept of "reasonable market participant" (as used in limb (d) of the definition of "information"). ACER indicates that a "reasonable market participant" "would be likely to use" information which ***"can be reasonably expected to be published"***. Pending order information sent to a broker is private information and is not published. Bid and offer information communicated in bilateral negotiations is also private and not published. Such information has, therefore, been incapable of being treated as "inside information" under REMIT, and the market has relied on ACER's Guidance to enable it to negotiate in the normal course. If the new proposed limb (e) were adopted, however, that Guidance would become unreliable (by making it clear at Level 1 that pending order information is "information"), undermining market participants' ability to negotiate.

(c) Finally, MAR provides a safeharbour, which enables brokers in the financial markets execute trades to enable them to carry out their brokerage functions for their clients – see article 9(2)(b) of MAR. A similar safeharbour at article 9(2)(a) protects legitimate dealing activity by market participants negotiating in the normal course. REMIT has neither of these safeharbours, so that the introduction of the new limb (e) without a similar set of safeharbours risks having the unintended consequence of prohibiting legitimate brokerage and trading activities.

Algorithmic Trading

The European Commission proposes to impose far reaching and onerous obligations on market participants who engage in "algorithmic trading", complete with rights for the national regulatory authorities to audit the use of such algorithms (physical and financial).

This proposal does not appear to be driven by an acknowledged regulatory failure of the REMIT regime, but by a wish to "financialize" the regulatory regime for energy market participants.

We are concerned that the newly introduced Art. 5 (a) and Art. 2 (19) introduce wide-ranging obligations that are not clearly defined and will thus lead to legal uncertainty. For example, it is not obvious which information needs to be notified to ACER or a Member State NRA. We would also like to point out that current regulations already cover algorithmic trading and direct electronic access. Consequently, the proposed amendments are unnecessary as existing market conduct rules are sufficiently wide to cover the risks connected with these activities, and would constitute a double layer of regulation. For example, under MiFID, investment firms are already required to notify authorities when they engage in algorithmic trading or providing DEA access in gas and power derivatives. The inclusion of algorithmic trading by market participants trading wholesale energy products in REMIT would significantly expand the scope of what is already covered by financial regulation and would need to be carefully calibrated to avoid conflicts with existing regulation (e.g. MiFID algorithm rules) and remain proportionate to the risks.

We note that much of the liquidity in wholesale energy products is located in different liquidity pools, spread across multiple exchanges and broker platforms. As a result, market participants invariably have to use tools to enable them to trade appropriately and efficiently in such a fragmented environment. Those tools could fall within the (wide) notion of "algorithmic trading" under the proposed definition (and under the corresponding MiFID2 regime).

This would mean that most energy market participants would become subject to these obligations, becoming subject to upfront and ongoing financial and administrative burdens. This is likely to deter new entrants to the market and adversely affect liquidity.

It is important to note that, even under MiFID2, most energy derivative market participants are **not** subject to the algorithmic trading regime. That regime applies only to firms which are required to be authorised under MiFID2 and to firms which trade in their own right as a member of an exchange or a direct participant on a MiFID2 trading venue. In other words, the MiFID2 regime imposes these obligations on financial institutions and the larger, self-sufficient market participants, but not on energy industry participants, which trade as the customer of a broker on a trading venue.

MiFID2 takes a more proportionate approach than is proposed here for REMIT.

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Direct Electronic Access

The European Commission proposes to impose systems, controls and reporting obligations on market participants who provide "direct electronic access" (**DEA**) to an organised marketplace.

We note that MiFID2 already regulates DEA services relating to Financial Instruments, where DEA is a common feature of, in particular, exchange-traded financial markets activity. The current proposals will create double layer of regulation, which cause legal uncertainty for Market Participants, where the risks have already been addressed.

In the wholesale energy markets, however, DEA plays a critical role in enabling new market participants to begin to operate. It is generally understood that it can take **a very long time** for new market participants to agree OTC bilateral trading agreements with a sufficient number of counterparties to enable trading activity to operate effectively. New entrants therefore often rely on DEA relationships as a mode of market entry, while such agreements are being negotiated.

It is important to note, that even under MiFID2, most energy derivative market participants are **not** subject to the Direct Electronic Access regime. That regime applies only to firms which are required to be authorised under MiFID2.

There is a risk that the imposition of the proposed DEA obligations will increase the costs – and potential liabilities – for market participants offering these services. An increase in the costs of – or reduction in the availability of DEA services for new entrants – would make it much harder for new firms to start trading.

Application and enforcement of the REMIT provisions

We note with concern that ACER new powers for complex, cross-border market abuse cases can sometimes result in a widening of the scope of the obligations and prohibitions for firms. Based on the proposal, ACER would obtain new supervisory and investigatory powers (inspections and information requests) to support and supplement the enforcement activities of the National regulatory authorities (NRAs). Although NRAs would remain ultimately competent to enforce and sanction REMIT breaches of firms, we are concerned about the inclusion of ACER in the regime as we believe its role could take a far-reaching approach. Similarly, we believe that the possibility for NRAs to delegate responsibilities to ACER for the effective supervision of the cross-border energy market participants/groups could acquire a concerning approach if it ends up negatively impacting the protection of the rights of the market participants.

Transaction Reporting and Disclosure of Inside Information

In our view, the proposal seems to fall short to simplify reporting and disclosure of inside information for market participants. There is only a new provision on Organised Market Places ("OMPs") which provides that OMPs should be required to provide the full order book data set to ACER. This falls short of introducing the desired single-side-reporting of OMPs. Also, the proposal does not provide for the

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possibility to set a threshold for the disclosure of inside information which the energy associations and firms requested.

Other points of interest

- **Integration of ACER Guidance**. The proposal contains some changes to transpose certain items of the ACER Guidance into the REMIT text, for example that inside information should be disclosed through IIPs, and transactions reporting should be performed through RRMs. In our view, these items reflect the current market/supervisory practice and consideration should be given to the feasibility and appropriateness of transforming such practice into a Level 1 legal requirement. For example, the current ACER REMIT Guidance addresses the situation where a market participant is unable to use an IIP because there is an outage at the IIP. The Commission's proposed changes to REMIT do not address this situation- or the situation where there simply is not an IIP available. Nor do the proposals for IIP registration adequately address essential questions such as fair, reasonable and non-discriminatory access for all market participants.

- **Definition of wholesale energy product**. We recognise the intention to ensure that this definition aligns better with the LNG market data regime. We note however that the proposed drafting gives rise to an unintended uncertainty. The phrase "which may result in delivery in the Union" could be taken to include contracts between a seller (A) and a buyer (B) for delivery outside the Union, which then lead to delivery in the Union by B under a separate contract where B sells to a buyer (C) in the EU. We do not believe that is the intended effect and suggest is limited to wholesale energy products delivered in the Union, as proposed by the Parliament in their amendments.

- **Definition of Persons Professionally Arranging Transactions ('PPAT').** We are concerned by the inclusion of "professionally engaged […] in the execution of transactions in, wholesale energy products" in the definition of PPAT. The additional reference to 'execution' would be superfluous as Market Participant definition already captures trading on own account. The additional reference to 'execution' would also ultimately oblige any person who, as part of its profession, is counterparty to a transaction relating to a wholesale energy product (including, for example, any end user[3] buying a wholesale energy product for its energy-intensive industrial process) to monitor and report to National Competent Authorities any suspicious order to trade or a transaction under REMIT Art. 15. This requirement seems overall disproportionate, considering these persons' actual activity in the market.

- **LNG Benchmarks and LNG Market Data Reporting (7(a) / 7(c)).** We believe the Commission's proposal to include the "emergency" LNG Benchmark and LNG Market Data reporting

[3] End consumers above the 600 GWh per year threshold in REMIT Art. 2(5).

(COUNCIL REGULATION (EU) 2022/2578) into the Level 1 REMIT requirements goes beyond the scope of the original requirements. If it is necessary to keep these emergency provisions, we believe that any wholesale energy product reporting should be harmonised with the existing Article 8 reporting requirements, where ACER can already access most required data from the existing reporting mechanism, albeit with an amendment to the reporting timeframes. Due to the near real time nature of the reporting for the LNG Market Data, it is impossible for market participants to apply all of their traditional controls and ensure data quality. Most processes require independent validation between counterparties, which can take at least a day.

3. About CMCE

CMCE is the only association in Europe representing the range of commodity market participants - agriculture, energy, metals and other commodity market participants, benchmark providers, price reporting agencies, and trading venues operating in the EU, EEA, Switzerland and neighbouring countries. The majority of CMCE members use commodity derivative markets to hedge the risks related to their physical activities and assets. CMCE's key purpose is to engage with policymakers and regulators to promote liquid and well-functioning commodity derivative markets in Europe.