



**OFGEM Call for evidence – Pricing benchmarks in gas and electricity markets**

**A response by the Futures and Options Association**

**July 2013**

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### 1 Introduction

- 1.1 This response is submitted on behalf of the Futures and Options Association (**FOA**), which is the principal European industry association for 160 firms and organisations engaged in the carrying on of business in futures, options and other derivatives. Its international membership includes banks, financial institutions, brokers, commodity trade houses, energy and power market participants, exchanges, clearing houses, IT providers, lawyers, accountants and consultants (see Appendix 1)
- 1.2 Physical and financial markets globally adopt a wide variety of pricing benchmarks, which themselves are reflective of a great variety of market participants, circumstance and needs. A common theme across these benchmarks is their evolution over time with respect to the ever-changing needs of their respective markets and participants. This evolution has occurred across both the regulated and the un-regulated markets, and to a point where today the variety and number of benchmarks available to participants is significant.
- 1.3 For any producer of, or user of, a pricing benchmark, the key to its use is its integrity. This is reflective of its relevance to market users, the robustness of its methodology, and its transparency. Without integrity a benchmark has very limited worth. As an industry association the FOA believes that the PRA's provide a critical service to markets and market participants, bringing transparency where otherwise there may be opacity.
- 1.4 The FOA is consequently wholly supportive of efforts to improve the transparency, robustness and integrity of benchmarks across markets. However, and reflective of the evolution of benchmarks to meet the requirements of all market participants, the FOA would be wary of regulation that would endanger benchmark transparency or deter market users from submitting price data or from otherwise participating in or relying on any benchmark process.
- 1.5 In the context of the forgoing, the FOA supports:
  - the observation in footnote 9 in OFGEM's consultation in which it states that "*in considering the relationship of these issues to the LIBOR investigation, we concluded that although there might be some potential similarities, the risk to energy markets is lower due to fundamental differences between the two benchmarking processes. The LIBOR rate is based on contributions from market participants; PRAs, unlike Thomson Reuters, who formulates LIBOR, has discretion to disregard unreliable data; and there are multiple PRAs operating in energy markets*". In paragraphs 3.5 and 3.6 of its consultation paper, OFGEM has emphasised that its measures "*should be targeted towards any specific problem identified and would need to be thoroughly assessed to ensure that they are effective and proportionate*"; and that the need to avoid unintended consequences meant that they would look to "*work with stakeholders to identify and mitigate these*" and that the outcome of hearing the views and evidence of stakeholders may mean "*that it is not appropriate for OFGEM to take any action in this area*".

The FOA welcomes this cautious and measured approach to pricing benchmarks in cash and electricity markets.

- 1.6 In general terms, the FOA supports the use of codes of conduct for price reporting agencies and for data providers on the basis that they could be developed by the industry, and modified and improved by OFGEM and, once adopted, be the subject of regulatory monitoring to ensure compliance. Clearing, any such codes should accord with the IOSCO Principles and meet the need for differentiation and proportionality.

## 2 Response to Specific Questions

### **Question 3: In what ways do you use benchmark prices provided by price reporting agencies or other price benchmarking services?**

- 2.1 The FOA's members do not adopt a common approach regarding policies on providing information to price reporting agencies or other price benchmarking services. Firms are governed by their own internal compliance policies and some firms permit submission of prices to PRAs and some do not. However, whether market participants submit prices to PRAs or not, it is fair to say that the majority of market participants do make substantial use of price reporting agencies and benchmarks. The primary use is for contractual pricing, whether the pricing itself is on a fixed price or a floating price basis. The prevalence of floating pricing in some markets, often over an extended pricing period, means the consistency of benchmark assessment and calculation holds equal importance with the methodology of a benchmark. This consistency of assessment/calculation is also important for those participants assessing risk in markets and their portfolios. Benchmark analysis over time is a key component in the risk assessment process. Benchmarks also enable participants to assess trends in relevant markets directing both market activity and risk assessment.

### **Question 4: Do you use a single price provider only, or a combination or variety of prices?**

- 2.2 In response to the question of whether a single price provider or a combination of price providers is used, most market participants would agree that using several price providers and benchmarks is preferable to using a single provider or benchmark. It may not be, and it is unlikely to be, possible for a market participant to adopt one PRA's provisions and methodologies. This is particularly the case for the non-financial markets such as commodities, where the localised and regionalised nature of markets, combined with the variety of market participants, means the benchmark requirements are highly specialised. A number of PRA's covering the specialised markets and offering differing methodologies is crucial to enabling participants to tailor their physical and financial exposures and associated requirements.

### **Question 6: In the context of GB gas and electricity markets, do you consider the current arrangements whereby price reporting agencies operate under a self-regulatory regime are fit for purpose?**

- 2.3 Our members feel that in the context of the GB gas and electricity markets the current arrangements whereby the price reporting agencies (PRAs) operate under a self-regulatory regime could be fit for purpose. However, in the current climate, and as a reflection of the importance of price benchmarks to market integrity, they do support the strengthening and continual evolution of the regime as follows:
- PRAs following tailored codes of conduct as set out in the IOSCO Principles for Financial Benchmarks and the IOSCO Principles for Price Reporting Agencies.
  - The requirement for Benchmark administrators to disclose compliance with the IOSCO Principles and in the case of Oil PRAs the voluntary adoption and implementation of the PRA Principles.
  - The intention to establish a review process of compliance over the next 18 months and the independent oversight and enforcement of compliance with these principles through local competent authorities.

In summary the FOA believes that any regulatory oversight should be proportionate and should endeavour to avoid generating undue levels of legal risk or 'pass through' costs for benchmark users and price contributors.

## **APPENDIX ONE**

### **LIST OF MEMBERS**

# FOA Members

## FINANCIAL INSTITUTIONS

ABN AMRO Clearing Bank N.V.  
ADMISI  
AMT Futures Limited  
Banco Santander  
Bank of America Merrill Lynch  
Banca IMI S.p.A.  
Barclays Capital  
Berkeley Futures  
BGC International  
BNP Paribas Commodity Futures  
Bank of New York Mellon SA/NV  
Citadel Derivatives Group (Europe)  
Citigroup  
City Index  
CMC Group Plc  
Commerzbank AG  
Crédit Agricole CIB  
Credit Suisse Securities (Europe)  
Deutsche Bank AG  
ETX Capital  
FOREX.COM UK  
FXCM Securities  
GFI Securities  
GFT Global Markets UK Ltd  
G.H. Financials Limited  
Goldman Sachs International  
HSBC Bank Plc  
ICAP Securities Limited  
IG Group Holdings Plc  
International FC Stone Group  
InvestecWIN  
Jefferies Bache Limited  
JP Morgan Securities  
Liquid Capital Markets  
London Capital Group  
Macquarie Bank  
Mako Global Derivatives  
Marex Spectron  
Mitsubishi UFJ Securities International Plc  
Mizuho Securities USA, Inc London  
Monument Securities  
Morgan Stanley & Co International  
Newedge Group (UK Branch)  
Nomura International Plc  
Rabobank International  
RBC Europe Limited  
Scotiabank Europe  
S E B Futures  
Schneider Trading Associates  
S G London  
Standard Bank Plc  
Standard Chartered Bank  
Starmark Trading  
State Street GMBH London Branch  
The Kyte Group  
The RBS  
UBS Limited  
Valbury Capital Ltd  
Wells Fargo Securities

## EXCHANGE/CLEARING HOUSES

APX Group  
CME Group, Inc.

Dalian Commodity Exchange  
European Energy Exchange AG  
ICE Futures Europe  
Johannesburg Stock Exchange  
LCH.Clearnet Group  
LMAX Limited  
MCX Stock Exchange  
MEFF RV  
Nasdaq OMX  
Nord Pool Spot AS  
NYSE Liffe  
Shanghai Futures Exchange  
Singapore Exchange  
Singapore Mercantile Exchange  
The London Metal Exchange  
Tradeweb  
Turquoise Global Holdings

## SPECIALIST HOUSES

Amalgamated Metal Trading  
BASF Metals Forwards Ltd

Cargill Plc  
ED & F Man Capital Markets  
Glencore Commodities  
Gunvor SA  
Hunter Wise Commodities LLC  
Koch Metals Trading Ltd  
Metdist Trading Limited  
Mitsui Bussan Commodities  
Natixis Commodity Markets  
Noble Clean Fuels  
Phibro GMBH  
J.P. Morgan Metals  
Sucden Financial  
Toyota Tsusho Metals  
Triland Metals  
Vitol SA

## ENERGY COMPANIES

BP International IST  
Centrica Energy  
ChevronTexaco  
ConocoPhillips Limited  
E.ON Energy Trading SE  
EDF Energy  
EDF Trading Ltd  
GDF Suez Branch Energy International  
Petrolneos Refining and Trading  
Phillips 66 TS Limited  
National Grid Electricity Transmission Plc  
RWE Trading GMBH  
Scottish Power Energy Trading  
Shell International

## PROFESSIONAL SERVICE COMPANIES

Ashurst LLP  
ATEO Ltd  
Baker & McKenzie  
Berwin Leighton Paisner LLP  
BDO Stoy Hayward  
Bovill Limited

Cadwalader, Wickersham & Taft LLP  
Clifford Chance  
Clyde & Co  
CMS Cameron McKenna  
Deloitte  
Dentons UKMEA LLP  
Ernst & Young LLP  
FfastFill  
Fidessa Plc  
Freshfields Bruckhaus Deringer  
Herbert Smith Freehills LLP  
Holman Fenwick Willan LLP  
ION Trading Group  
JLT Risk Solutions Ltd  
K&L Gates LLP  
Katten Muchin Rosenman UK LLP  
Linklaters LLP  
Kinetic Partners LLP  
KPMG  
McDermott Will & Emery LLP  
Macfarlanes LLP  
Mpac Consultancy LLP  
Norton Rose Fulbright LLP  
Omgeo Ltd  
Options Industry Council  
Orrick, Herrington & Sutcliffe LLP  
PA Consulting Group  
Pughview Ltd  
R3D Systems Ltd  
Reed Smith LLP  
Rostron Parry  
Shearman & Sterling (London) LLP  
Sidley Austin LLP  
Simmons & Simmons  
SJ Berwin & Company  
SmartStream Technologies  
Speechly Bircham LLP  
SunGard Futures Systems  
Swiss FOA  
Trading Technologies  
Traiana Inc  
Travers Smith LLP  
Traypor

