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Graham Knowles
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1August 2013

Dear Graham,

Re: Pricing benchmarks in gas and electricity markets - a call for evidence

ICIS is the energy and petrochemical-market news, media and reporting business of Reed Elsevier plc, a world leading publisher of professional information for the science, medical, legal, risk management, and business to business sectors.

ICIS is a global leader in the reporting of market information, prices, news and commentary for the petrochemical markets; the leading European reporter of natural gas, liquefied natural gas, and power prices; and a key global news and price-reporting service in oil, coal, fertilizer and emissions markets. ICIS employs over 800 staff worldwide, including around 200 in the UK. Some 350 of ICIS' staff are journalists engaged in reporting market prices and news.

ICIS has operated as an independent price-reporting media organisation (PRA) for over three decades and is fully committed to maintaining the highest standards when producing its market reports.

ICIS creates, owns and licenses media content as a news media organisation. To this end, we, in common with other independent price-reporting organisations are dependent for our existence on our reputation for providing truthful, honest, unbiased reporting as well as upholding the highest journalistic principles of verification, corroboration and authentication.

As a media organisation, ICIS operates news bureaux around the world which focus on commodity market news and commentary. On a daily basis, our reporters actively seek to ensure the prices they publish are not open to abuse and to ensure that information we collect is checked for inconsistencies and inaccuracies. Our reporters seek not only to validate data but also to understand the reasons why markets move as they do and confirm that prices make sense in the context of the market movements.

We would like to express our gratitude for the evident care that Ofgem has taken in researching the subject of price benchmarking, which has led to some of the most perceptive and helpful analysis that we have read anywhere in recent years.

ICIS recognises the need to provide confidence to markets, regulators and governmental bodies to ensure that the assessments and information we produce are robust and subject to best practice.

We are more than happy to meet with you to further discuss our answers at your convenience. Please feel free to contact me on +447920 803271 or richard.street@icis.com.

Yours sincerely,

Richard Street[1]

Head of Regulation and Compliance - ICIS

[1] Please note as this document has been sent electronically it will not be physically signed

ICIS Response to Ofgem Questions

Introduction

Although the Call for Evidence does not ask any questions on Chapter 1, we believe it may be worthwhile to summarise developments that have taken place since the Call for Evidence was published, and which are relevant to the section in Chapter 1 of the Ofgem consultation.

Section 1.4. The G20 Agenda:

On 17th July, IOSCO issued its *Final Report on its Principles for Financial Benchmark.* There had been some speculation that these new IOSCO principles might modify or even supercede the PRA Principles. However, IOSCO's new *Final Report* unreservedly reaffirms the PRA Principles and also distinguishes them from IOSCO's more generalised new principles in the following terms:

> *"Specific application for oil PRAs*
>
> *In October 2012 IOSCO adopted the PRA principles, which were developed in collaboration with the IEA, IEF and OPEC. IOSCO recommended voluntary adoption and implementation of the PRA Principles and established a review process over the 18 months following their publication, pursuant to which IOSCO in collaboration with the IEA, IEF and OPEC will evaluate the degree to which the PRA Principles have been implemented by PRAs. IOSCO expects that the oil PRAs will continue with and implement the PRA Principles.*
>
> *IOSCO will, in the context of its collaboration with the IEA, IEF, and OPEC, consider the need in due course for any modification of the PRA Principles to align them more closely with these Benchmark Principles."*

Section 1.5: The ESMA/EBA Agenda:

On the same date Ofgem published its Call for Evidence, ESMA and EBA issued their "*Principles for Benchmark Setting Processes the EU".* The Introduction clarified that the ESMA-EBA principles are "*without prejudice to the IOSCO Principles for Oil Price Reporting Agencies*"

Question1: Do you agree with our assessment of the issues?

We welcome the clear, well-balanced, evidence-based approach that Ofgem has taken in Chapter 2 including:

- The brief summary of the journalistic process that underlies a PRA price assessment;
- The recognition that PRAs operate in a competitive environment and "*may be deemed to have a commercial incentive to ensure that their customers retain confidence in their products",*
- The contrasts made between Libor and PRA benchmarking processes and the conclusion that there is lower risk profile in the latter; and

- The references to the European anti-abuse frameworks of REMIT and MAR;

For the purposes of clarity we would like to note that through section 2.12 is true in essence that *PRAs provide prices which market participants who subscribe to their services can use as a reference for prevailing prices in the over the counter market*. The price provided by the PRA is issued after the close of the market; as such it is not in fact used in spot trading but rather as a reference to the previous days trading.

We would like to single out for particular attention the section "*Forming a benchmark price*" in paragraphs 2.16-2.22 and the two illustrations included. This clearly and accurately, in the view of ICIS, explains the impacts, both positive and negative, of regulation on the information flows that are essential for well-functioning oil and other energy markets.

Section 2.19 and 2.20 are especially appropriate:

> *"..some types of regulation may also introduce risks to the process. In particular, greater regulatory scrutiny of the information flows could introduce a perception of risk (irrespective of whether the risk is real) to those providing the information. Regulation should increase the quality of the information provided, but could reduce the willingness of parties to provide it. Information is provided on a voluntary basis and the simplest way to mitigate this risk may be to withdraw cooperation and decline to provide it. This in turn can lead to a breakdown in the quality of the price assessment process, with negative consequences for the market and for consumers*."
>
> *"Good information is essential for a well-functioning market. It is therefore very important for both regulators and market participants alike to consider this relationship and ensure that the market continues to have good quality information available."*

Ofgem's analysis reinforces and expands on IOSCO's warning in its Final Report on "Principles for Price Reporting Agencies":

> *"It is important to understand that these principles recognize that there is no requirement on any physical market oil participant to submit transaction data to PRAs. Because data are submitted on a voluntary basis, precipitous regulation of PRAs or requirements that oil market participants who submit data to PRAS submit all of their transaction data potentially could result in some oil participants to decrease or even ceases their submission of data to PRAs"*[2]

We would commend Ofgem's analysis as required reading for any authority that is contemplating regulatory intervention in benchmarking in these areas. Unfortunately, there is not always sufficient awareness among policy makers about the differences that exist between benchmarking processes in pure financial markets and those in commodity markets.

In this context, we strongly support the approach that Ofgem outlines:

> "*We are mindful that any action might come with unintended consequences and that we would need to work with stakeholders to identify and mitigate these."*

We understand from the consultation that general concerns surrounding price reporting agencies in the gas market include allegations made in the national press that reporters are

[2] Pages 8 and 34

poorly trained, and that PRAs fail to follow their published methodologies, particularly with regards to the sourcing of information.

It is essential from a business perspective that the information provided by ICIS is of the highest quality and accuracy based on actual information provided by market participants. ICIS staff are therefore held to high Editorial Standards that are founded on ICIS' reputation for independence, accuracy, impartiality and objectivity and are published on our website.

ICIS recognises that our customers rely on us for accurate information and base commercial decisions on that accuracy. Customers must feel confident that information relayed by ICIS, whether verbally, in print, on screen or in data form, has not been influenced by any commercial, personal or other interests.

The international reputation of ICIS has been established through dedication to getting the facts right and bringing transparency to opaque markets.

Not only do we recognise that from a professional standards viewpoint this imposes a special duty of care on employees of ICIS concerned with information-gathering, content creation and publication, but also from a commercial perspective we recognise the value in maintaining this reputation.

We therefore stipulate that our reporters must not engage in any activities, or be perceived to engage in any activities, that might be prejudicial to ICIS' reputation for independence. In addition ICIS staff are fully trained and undergo a comprehensive training program covering editorial, journalistic skills, market knowledge, information technology and other management and development skills, with training in ICIS internal procedures and practices.

Question 2: What is your company's policy on providing information to price reporters or other price benchmarking services?

This question is targeted at market sources, but it is also a question of central importance to ICIS.

In terms of the market data received, ICIS recognises that the information from sources and the views reported from market participants will not necessarily be objective. ICIS therefore has publically pledged to cross-check information to ensure news, price assessments, market commentary and other content remain accurate and impartial.

While we validate all information we receive and verify all sources, we request that market participants providing us with information assist us to enable ICIS to ensure that our reports and journals are as complete and accurate as possible. It should be noted that ICIS is committed to operating within a competitive market and therefore does not enter into exclusive arrangements with market sources or any other similar arrangement which restricts the ability of a competitor to create a competing product.

Of course contributions by market sources in energy markets are entirely voluntary. Ofgem notes:

> *"…price reporting agencies rely on market participants to supply them with good quality information*" [3]; and
>
> "*some participants have stated publicly that they do not provide information to PRAs."* [4]

ICIS acknowledge that there is a clear public interest in encouraging markets participants to contribute to overall market transparency by providing information to PRAs. In our experience, one factor in the hesitation and sometimes unwillingness of some market participants to supply price information to PRA journalists is their confusion about official attitudes and/or their perception that they place themselves at legal or financial risk by doing so.

Understandably, the recent focus by Ofgem, DG COMPETITION and DG MARKT on possible manipulation by market sources has led markets participants to question whether they should continue to provide information to market reporters. Some participants appear to believe that authorities would prefer them not to, while others consider the (avoidable) risks are not worth the taking.

As Ofgem notes:

> "*greater regulatory scrutiny of the information flows could introduce a perception of risk (irrespective of whether the risk is real) to those providing the information……… the simplest way to mitigate this risk may be to withdraw cooperation and decline it. This is turn can lead to a breakdown in the quality of the price assessment process, with negative consequences for the market and for consumers."* [5]

We would like sectoral regulators and competition authorities to keep in mind that regulatory interventions can unwittingly lead to market participants withdrawing their contributions to market transparency.

There is a need for regulators to reconsider the message conveyed and to find ways that encourage, rather than discourage, contributions from market sources. Present messaging is unclear and often negative. We would like to see Ofgem and ACER taking a pro-active leadership role, resulting in more transparent energy markets, with benefits for market participants, manufacturers and consumers.

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

As a PRA, ICIS' clients are spread across a wide spectrum of business, public sector, academic and other users. It is recognised that a broad spectrum of parties, including producers, generators, refiners, processors, distributors, traders, manufacturers and other private and public organisations with interests in international commodity markets refer to

[3] Executive Summary, paragraph 1

[4] Note 18.

[5] Section 2.19

and rely upon the integrity and independence of the price assessment reporting process undertaken by ICIS and other PRAs.

Understandably, financial services regulators have focussed on the minority usage for purposes of trading derivatives. We ask regulators, however, to bear in mind that the majority of our clients do not use price assessments for these purposes. Only a small minority of ICIS's clients use price assessments as benchmarks for trading in derivatives.

The overwhelming majority use price assessments for other purposes such as research, calculating tax liability, or pricing long term physical supply deals. In fact independent analysis undertaken shows that financial commodity trades comprise less than 3% of total derivatives markets, with non-commodity assets such as interest rate derivatives offering the greatest systematic risk. Of the trading in the commodities sector in the EU, energy makes up around 3% of the total. Energy trading therefore makes up less than 0.1% of all financial commodities trading in the EU.

There is a risk; therefore, that if regulatory intervention is focussed on the minority use of a PRAs benchmark prices, this could have wider, and possibly unintended, consequences for the majority use of the prices.

ICIS believes the most important focus should be that PRAs are able to compete to publish quality price assessments that are trusted to represent fair market value.

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

ICIS recognises that it is not the only PRA organization offering news, pricing assessments and market intelligence on the sectors it covers, with the likes of Platts, Argus Media and others offering similar services.

Customers may also choose to use broker generated indices such as Tankard, LEBA and individual broker indices.

ICIS encourages market participants to provide bona fide information to allow for comprehensive and accurate analysis to help contribute to a healthy and transparent price discovery process and never discourages sources from contributing to competing price reporting organisations.

Question 5: What are your views on the terms of the IPRO code of conduct and the various published methodologies of the price reporting services with particular reference to gas and electricity markets?

<u>IPRO Code</u>

The IPRO code allows for greater transparency and enables market participants to have confidence in the information they receive. It is designed to operate at a companywide level for a PRA that operates in all commodities markets.

Following the advice provided to PRAs by IOSCO in Dubai in January 2013 that PRAs should conduct audits against the IOSCO PRA Principles and not against the IPRO Code, the PRAs have redrafted the IPRO Code to work in conjunction with the IOSCO PRA Principles.

While the IOSCO principles look and focus on oil markets IOSCO made clear that PRAs should extend these standards to all commodity market price assessments and ICIS, Platts, Argus Media and OPIS all confirmed this as their intension in Dubai in January 2013. We therefore encourage Ofgem to consider the two documents in conjunction.

As such, ICIS' companywide compliance structure and audit process is designed to meet both sets of standards.

We note that the existing proposals from IOSCO are clear that all obligations to use benchmarks that fulfil the IOSCO requirements would be placed on market participants as these are currently regulated (i.e. exchanges for cleared derivatives and counterparty traders for OTC derivatives).

Methodologies

ICIS has over 150 methodologies and publishes thousands of prices every day. Each price is reported under a set methodology which is followed by an independent price reporter(s) and is actively investigated using journalistic skills and knowledge by someone with market knowledge and understanding.

At the core of this is a compliance framework, with the combination of independent journalistic rigour acting as an essential part of the process in both providing confidence to the market and providing transparency to the process.

While methodologies have changed and evolved with the commodities markets, this basic structure of price reporting is over a decade old in the UK gas industry and a century old in the Oil industry. It has repeatedly been demonstrated to stand up to legal challenge and independent review far more effectively than any other mechanism.

Experience suggests that methodologies need to evolve over time as the market structures and behaviours change. As well as a formal process for general methodology review, which ICIS commits to repeat at regular intervals, there is also a continuous internal review process and process for responding to external feedback and market changes. When conducting a general review of its methodologies, ICIS will ask broad general questions to ascertain how well the methodology is performing in fulfilling its overall purpose, which is to provide a reliable measure of physical market value. ICIS alsoconsults on specific changes to the methodologies from time to time. These changes may be to address an issue identified by ICIS in market structure, market behaviour, an existing methodology or in reaction to feedback from customers or market participants on any of these.

ICIS is committed to conducting a fair and open consultation process. It will therefore only decide on a particular methodology change after the consultation process has concluded. Market participants should not assume that because a change is proposed in a consultation that ICIS is minded to make the change. We would therefore encourage all market participants to engage in the consultation process allowing for a fair and transparent process.

For example, ICIS followed this process when it consulted on it its European Spot Gas Markets methodology in February 2013. ICIS asked general questions around whether the methodology was fit for purpose and proposed an alternative closing price methodology, which received widespread support. Although there was little consensus on the exact process to be used for this closing index, ICIS has since worked to develop the methodology and will be launching a pilot closing index in 2013, alongside its existing assessments and indices.

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?

Yes. ICIS would make three points in response to this question.

1. The PRAs are extending PRA Principles to all price assessments, and not just to oil price assessments**:**

As Ofgem notes:

> *"The International Organisation of Securities Commissions (IOSCO) has undertaken work for the G20 group of governments to consider arrangements for the reporting of global prices by price reporting agencies. Many of the principles it drew up are seen as applicable to gas and electricity markets."*
>
> "……*many of the findings and recommendations from [the PRA Principles] are directly relevant to the reporting of gas and electricity prices."*

IOSCO, which shares that view, included the following sentence in its *Final Report on Principles for Oil Price Reporting Agencies* published in October 2012:

> *"Although the PRA Principles were developed in the context of PRAs and oil derivatives markets, PRAs are encouraged to implement the principles more generally to any commodities derivatives contract that references a PRA assessed price without regard to the nature of the underlying."*[6]

This sentence was repeated by IOSCO Committee 7 in March when it published a synopsis of the PRA benchmark workstream as part of an Implementation Questionnaire it sent to the PRAs.

As a result of this explicit IOSCO encouragement, the PRAs are extending the application of the PRA Principles to all their benchmarks, and not just to oil benchmarks. The IPRO Code likewise extends to all benchmarks.

2. The self-regulatory regime is buttressed by two independent validation mechanisms:

- Independent validation by market authorities: In its Final Report on the PRA Principles, IOSCO recommended "*The use by a market authority of its rule approval and/or review authority over derivatives contracts, as appropriate, to refuse admission to exchange trading or central clearing of any oil derivatives contract that references a PRA-assessed price which, in the opinion of the market authority, has been developed under policies and procedures that do not*

[6] Final Report PFOPRA Page 7.

reflect effective implementation of the PRA Principles and call into question the reliability of an assessment; and

- External audit: Under Principle 2.21 "*A PRA should appoint an independent, external auditor with appropriate experience and capability to review and report on the PRAs*

- *adherence to its stated methodology criteria and with the requirements of the principles."*

IOSCO Committee 7 and the PRAs have been working with the Institute of Chartered Accountants of England and Wales (ICEAW) to finalise published guidance to assist external auditors that perform assurance audits on the PRA Principles. These audits are currently underway and will be completed by the beginning of October.

These two mechanisms provide strong independent assurance that the self-regulatory regime will be fit for purpose. However, it must be reasonable to point out that this is "work in progress". The IOSCO 18 months period for implementation has yet to run its course.

3. The G20 has required IOSCO to review implementation of the PRA Principles during an 18 months evaluation period beginning 5th October 2012.

Clarifying how it will undertake this task, IOSCO has stated that it

> "*will seek to obtain the input of market authorities, stakeholders, and PRAs on the degree to which the principles have been implemented, and may make further recommendations at the end of the evaluation period*"[7]

ICIS would encourage Ofgem to feed into this evaluation process to support the objective of maintaining a consistent international approach to benchmarking in energy markets. We would urge the UK to avoid introducing any measures that are inconsistent with the IOSCO process.

ICIS would suggest that adding additional regulatory constraints on PRA and market participants could result in an onerous process. If this were to happen the burden could be too great on market participants causing them to avoid submitting data by either removing themselves from the submitters list (if they can) or trade in a different jurisdiction with lower costs, ultimately resulting in the failure of the benchmark.

Way forward

ICIS believes that supporting the IPRO Code and/or the IOSCO PRA Principles would be a useful and measured regulatory approach. This could be done by requiring market participants to only reference numbers that are published in compliance with these standards.

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[7] Final Report PFOPRA p8

Implementing best practice in this way would ensure that regulation does not impact on the editorial independence of the price-reporting organisation. Nor would it infringe on the intellectual property rights of the media organisations that own the publications.

Rather, it maintains a fair and level playing field in the competitive price-reporting industry but at the same time introduces audited standards which must be applied across the independent price reporting organisation's whole business.

These principles have already been adopted internally, and encompassed within ICIS Compliance manual, to ensure that it is innate within the culture of ICIS staff and best practice. Governance and Compliance are key and run hand in hand with the way ICIS strives to run its business in order to maintain quality.

ICIS works in a competitive market and as such we see the quality of our product as our Unique Selling Point. As such compliance with our quality standards and adherence to self-governance structures put in place is essential to maintain a competitive edge.

Question 7: Are there any other issues that you wish to raise in the context of this call for evidence?

We would like to comment on potential "next steps", which are referred to in several passages of the Ofgem paper:

> *"If we were to conclude that an intervention by Ofgem was needed, our response could range from facilitation to support effective regulation, to a more significant regulatory intervention. We may conclude that some response is required but another agency is better placed to take it forwards"*[8]
>
> *"We have made a preliminary consideration of a range of measures available to us if, in the light of further developments, we consider that action may be warranted. Our response could range from an approach that would see us act as a facilitator to support effective self-regulation to a more significant regulatory intervention."*[9]
>
> *"…if evidence emerges that there are gaps in the current approach of self-regulation or it is apparent that supporting actions are needed to ensure that effective price benchmarks remain available to market participants, we will need to assess how best to respond. It might be the case that any issues would be addressed by on-going work overseen by other agencies. However, if it were clear that this was not the case we would need to consider carefully taking forward measures in this area, either by ourselves of if appropriate working with another relevant agency such as the Financial Conduct Authority."*[10]

We welcome Ofgem in a role as **"***facilitator to support effective self-regulation".* As already suggested in our response to Question 2, we would like to see Ofgem and ACER take a more pro-active role in encouraging market participants to supply information to PRA journalists. They could also assist DG MARKT and financial services regulators to

[8] Executive Summary p.5
[9] Section 3.4
[10] Section 3.6

understand the differences between financial and commodity markets and how the distinctive benchmarking processes in oil and energy markets respond to the characteristics of those markets.

We also feel a need to place on record the journalistic basis of ICIS's activities, which Ofgem itself refers to in section 2.15. This is one of the key differentiators with other types of benchmark activities, and one of its strengths. PRAs have no conflicts of interest. It does not matter to a PRA if prices rise or fall. Instead, and as Ofgem points out, PRAs "*have a commercial incentive to ensure that their customers retain confidence in their products."*

Journalists employed by ICIS produce price assessments, and not benchmarks. It is the market itself that decides whether to use any assessment as a benchmark, and only a small handful of the many thousands of price assessments that are produced each day by ICIS's journalists are used in this way as benchmarks. The number is insignificant as a percentage of the output of ICIS's journalists. To be clear, in the case of the PRAs there is no activity of "benchmark setting" that is separate from the journalistic activity of providing assessments. The handful of ICIS assessments that the markets themselves decide to use as benchmarks are produced in precisely the same journalistic way as the many thousands of price assessments that are not used as benchmarks.

The reason for drawing attention to the journalistic foundation of ICIS's activities is not just to point to its strengths, when compared with Libor and similar conflicted benchmarking processes, but also a reminder that there are no precedents in the UK for regulatory oversight of the on-line media. The closest analogy we are aware of is *The Investment Recommendation (Media) Regulations 2005* which are available at http://ec.europa.eu/internal_market/finances/docs/actionplan/transposition/uk/d13.4-ml-2- HMT's Explanatory Note at the back of the regulations is clear and informative. This initiative was to reinforce, rather than replace, media self-regulation.

ICIS offers all its assistance to Ofgem as it progresses its agenda and, as we have already stated at the beginning of our response "*we very much welcome further engagement*". We intend to make self-regulation effective and to do whatever we can to ensure the integrity of oil and other energy markets

Once again, I thank Ofgem for its constructive engagement with the PRAs and, in its Call for Evidence, for a most valuable contribution to the debate concerning benchmarking in oil and energy markets.