



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

