



29 April 2016

Ofgem
9 Millbank
London
SW1P 3GE

Dear Ms van Rensburg,

Further to our letter dated 16 September 2015, we are writing in connection with the letter issued by Ofgem in September 2015 regarding the Prohibition of Market Abuse under the Regulation on wholesale energy market integrity and transparency under REMIT.

The communication has stimulated much discussion over the interpretation of some of the guidelines and raised queries with respect to which market participants would be grateful for clarification. These relate predominantly to whether certain aspects of standard trading activities constitute market abuse or whether they are a legitimate part of normal market functioning.

The main areas / activities in which clarification is requested are:

Automated Trading via Trayport and other Electronic Platforms.

It would be helpful if Ofgem could confirm that the use of Trayport (and other trading application software) functionality is accepted market practice and does not, in and of itself, constitute market manipulation. Trayport and their peers provide a number of trading functionalities, that are widely used by market participants, such as Icebergs, Ghosts, Spreads etc. These functions are clearly documented and many are designed to minimise human error (i.e. the individual orders could also be generated by humans, but are less prone to human error if programmed). The functionalities are transparent and are available to all Trayport users and have been used for years by the vast majority of market players. However, market participants are concerned that the nature of the functions (whereby the full extent of the bid/offer stack, a discretionary execution price or a desired spread remain hidden from the market) could be misconstrued. Specifically, these concerns relate to what is described as the practice of layering in the September 2015 letter. An analogous situation exists for other electronic energy trading platforms such as EEX TT Trader and ICE.

A more detailed example of the mechanism of an Iceberg trade is shown in the appendix to this letter.

Both the Trayport trading gateway and the use of Iceberg orders are widely accepted by Exchanges as standard practices, e.g. trading participants do not need to notify the European Energy Exchange (EEX) about their use or intended use of the facility. ICE Futures U.S. has also clarified that the use of Iceberg orders, in and of itself, is not considered a violation of its rules. However, a violation may exist if an Iceberg order is used as part of a scheme to mislead other participants; for example, if a market participant pre-positions an Iceberg on the bid and then layers larger displayed quantities on the offer to create artificial downward pressure that results in the Iceberg being partially or completely

filled. While it would therefore not be appropriate to offer blanket "clearance" of strategies executed via these tools, it would nevertheless be helpful for Ofgem to acknowledge that the use of these tools per se was accepted market practice.

Pre-Arranged Trades:

OFGEM's letter referred to pre-arranged trading on anonymous exchanges and stated that such prior arrangement is likely to amount to market manipulation. While market participants fully accept that pre-arranging trades can in certain circumstances be for manipulative purposes, a significant proportion of gas and power contracts on exchanges are in fact pre-arranged, utilising brokers and the exchange's block trading, EFRP or other approved mechanism which permits and facilitates such pre-arrangement. The majority of such trades are block trades. As the liquidity within the power markets resides primarily within the broker (rather than the exchange) market, such trades are necessary to enable market participants to conduct their everyday physical and risk management activities without causing significant price fluctuations. As such, it would be helpful for OFGEM to acknowledge that where participants are complying with exchange rules, activity should not be viewed as manipulative, at least not simply due to the fact that it was pre-arranged *per se*.

It would be useful also to obtain a definition of what constitutes pre-arranged trading in the abusive sense; and, also in the definition, to exclude trade registration, block trades and EFPs, provided these are executed according to the rules of the exchange.

Potential Differences in Interpretation between Ofgem and an Exchange Market Surveillance Department or an Exchange's Regulatory Body.

Where a UK power trade is registered with an exchange for clearing, such trade and the registering counterparties to the trade are covered by the exchange's rule book and the exchange's market surveillance team. Exchanges have their own market surveillance rules and functions and operate under the rules of their regulator (e.g. FCA, German State of Saxony). It would be useful to enter into a dialogue with Ofgem on how to resolve a situation where Ofgem interprets a particular trade or behaviour as potentially abusive but the Exchange Market Surveillance Department and its regulator view such activity as acceptable market practice. In other words, if an exchange has a rule that Ofgem considers unacceptable, what would be Ofgem's course of action?

Conduct of Enquiries and Investigations

The industry would also welcome an open and collaborative approach to the conduct of enquiries and investigations.


Examples of this would include:

- It would be useful for the industry if, where possible, Ofgem provided more details of the context of requests for information to allow for the exchange of more targeted interpretation, commentary and other relevant drivers and facts rather than just merely the information requested.

- While Ofgem's formal powers and procedures are well described, more informal contacts would facilitate a more meaningful dialogue and allow resources to be focused on the highest risk cases. Informal discussions with the industry on particular events may enable concerns to be allayed earlier or highlight related concerns not immediately discernible in the factual data.
- The opportunity for exchanges between Ofgem and company senior management at an early point of enquiries would also help to facilitate the efficient conduct and resolution of cases. The purpose of such interaction would be to achieve an additional level of clarity and transparency and provide a greater level of cooperation.
- It would be helpful if Ofgem were able to confirm that queries or investigations have been handled satisfactorily or closed rather than leaving companies with uncertainty as to whether cases are ongoing, on hold or just left open. (For example, subsequent to a market event that merits an enquiry, the FCA frequently issue a clarification identifying best practices in such circumstances).
- Ex-post discussion and sharing of learning points from significant investigations (irrespective of the outcome) would help to improve mutual understanding of effective enforcement and facilitate industry interaction and vigilance.

We appreciate our previous conversations on these topics. Our members found those meetings extremely valuable. We would welcome Ofgem's clarifications on the above issues and should be grateful for the opportunity to work with Ofgem to develop an appropriate platform to address such matters in a transparent, collaborative environment on a go forward basis. We remain at your disposal to discuss this letter in more detail.

Kind regards



Simon Puleston Jones
FIA Head of Europe

Appendix: Example of Iceberg Trade Mechanism and Impact on Market Efficiency

An Iceberg is a tool that creates a standard order that is visible to the market, but also has hidden quantity which is not visible to the market. Standard orders in the market will be auto aggressed by the Iceberg. In other words, the electronic platform will automatically execute the "Iceberged" volumes should bids/ offers become available at the desired price levels. This automatic execution will occur without further manual intervention. The trader enabling the Iceberg will know the amount of hidden volume; the broker (if traded via a broker) will know that there is a hidden quantity. Iceberg orders will be traded in normal clip sizes. Without the ability to enter an Iceberg a trader would need to manually enter every individual order in the usual traded clip size (at the same price level). If orders are executed, new standard orders would manually be entered into the system again (at the same price level). This is an inefficient and time-consuming activity for an individual that can be re-placed with a certain degree of automation. In practise, entering so many similar deals will also be prone to human error.

While the trader could choose to sell the entire Iceberg in one big fully visible trade (e.g. trade 500 MW in one order), this would undermine market efficiency and functioning because:

- The unusually high quantity would likely have a significant price effect (i.e. distort market price);
- Only very few (large) market participants would be able to trade the larger size ticket, which means in turn that other smaller market participants or new market entrants would be excluded from such a trade (i.e. smaller market participants would benefit from the liquidity that a traded Iceberg provides); and
- If there was no other market participant willing to buy the 500 MW, this could encourage others to 'front-run' the seller.

In general, therefore, an Iceberg is able to properly balance supply and demand, promotes liquidity and allows (otherwise) illiquid positions to be traded. This minimises the risk of not having a counterparty for a trade and ensures price fluctuations are minimised without compromising a market trend. There might still of course be very good reasons for trading a large quantity in one order for example for hedging purposes or on the intraday market when a sudden unforeseen demand materialises.