POSITION PAPER

Strengthening EU energy derivatives markets through enhanced supervisory coordination, not overregulation

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Executive summary

The EU Action Plan for Affordable Energy rightly recognises the importance of keeping energy affordable, while ensuring security of supply and accelerating the energy transition. Efficient and well-functioning energy markets are essential to this goal. Only if markets operate efficiently, they send clear price signals that attract new entrants, stimulate innovation and drive down costs over time. Derivative markets in particular allow energy producers and consumers to hedge risks and undertake the long-term investments the EU urgently requires.

Following the energy crisis, evaluations by ACER[1], ESMA[2] and the ECB[3] confirmed that European derivatives markets delivered on their purpose and contained adequate safeguards. They provided transparency on prices, allowed participants to manage risk, and helped firms weather the crisis during the highest price peaks. Nevertheless, policy discussions have floated the possibility of narrowing the exemption that allows energy firms to act in the market without being subject to banking-type regulation (the Ancillary Activity Exemption), imposing stricter position limits, and reintroducing price limits despite no clear evidence that such interventions are needed, nor clarity on what benefits they would deliver. Such measures will not lower energy prices. Instead, they would significantly raise trading costs that are ultimately passed on to the consumer.

Instead of introducing unfounded restrictions, the EU should focus on strengthening its energy derivative markets through enhanced supervision. With the revisions of REMIT, MiFID II/R, MAR and EMIR establishing an extensive regulatory framework, the time has come to take the next step on supervisory coordination. Enhanced data sharing and cooperation between regulatory authorities will help those authorities gain a broader and more integrated view of the market, benefitting both market surveillance and future policy-making.

Key Recommendations for the EU's Gas Market Task Force on market oversight

We recommend to

- Allow energy firms to act in the market without being subject to banking-type regulation by maintaining the current scope of the ancillary activity exemption
- Enhance data sharing among regulatory authorities through a dedicated data strategy
- Set up a collaborative platform for regulatory authorities

We strongly urge not to

- Change the current position limits regime
- Reintroduce price limits such as the market correction mechanism

[1] European gas market trends and price drivers - 2023 Market Monitoring Report, (October 2023), ACER, link
[2] The August 2022 surge in the price of natural gas futures - ESMA TRV Risk Analysis, (October 2023), ESMA, link
[3] Financial stability risks from energy derivatives markets - published as part of the Financial Stability Review, (November 2022), European Central Bank, link

What should be done

Maintain the current status of the ancillary activity exemption

The Ancillary Activity Exemption (AAE) enables energy producers, large industrial consumers, and commodity traders to engage in trading activities, such as risk transformation, portfolio optimisation, and gaining market insights, without being classified as investment firms provided these activities are ancillary to their main commercial business. Misclassifying such companies as investment firms would not only impose disproportionate regulatory burdens under a multitude of different sets of regulations but also harm European industry by increasing costs and disincentivising participation in the EU energy market. Frontier Economics and Luther Law have calculated the following consequences[4]:

Massive capital burdens: **Firms participating in the study were found to require between €1.15 and €8.55 billion in regulatory capital, with an average exceeding €3 billion**. These burdens stem from the Investment Firms Regulation (IFR), which was designed to address risks posed by financial institutions that manage client funds, not real-economy actors like energy firms. Energy firms neither fund their activities through deposits, nor engage in interbank markets or rely on central bank liquidity. Instead, they are financed through stable, diversified channels and backed by long-term physical assets. Imposing IFR requirements on these firms would tie up critical funds that could otherwise be used for investments in the energy transition, while also increasing cash liquidity stress during market volatility, due to regulatory margin requirements.

Frontier Economics developed a simplified example of an offshore wind project to illustrate how applying the IFR to energy companies could increase their financing costs, **increasing the cost of producing electricity could rise by 2% to 8%**. In the context of the €93 billion in annual investments needed to achieve the EU's power sector targets under the Fit-for-55 scenario (2021–2030)[5], this could mean an additional €2 to €7.5 billion in yearly investment costs for energy firms until 2030.

Costly restructuring: Although energy firms are not banks, an investment firm status would force them to meet the same requirements (e.g., licensing, operational requirements, compliance systems, reporting, IT changes) which would mean major organisational overhauls and high ongoing costs just to continue normal operations.

Weaker markets: To avoid these disproportionate burdens, many firms are expected to cut back or exit derivatives trading activities. This would reduce market liquidity, making it harder for companies to hedge price risks and weakening overall market stability. Non-financial actors will become dependent on financial actors to hedge their production or consumption, further increasing prices. This will directly impact energy consumers, as there will be more volatility and higher prices as a consequence.

In short, removing or narrowing the AAE, by removing or narrowing any of its three tests, would divert significant resources away from clean energy investments towards financial

[4] Principles Of Energy Market Regulation – Securing Efficient & Resilient Energy Trading, (April 2024), Frontier Economics and Luther Law Firm, link
[5] Investment needs assessment and funding availabilities to strengthen EU's Net-Zero technology manufacturing capacity (SWD(2023) 68 final) - Staff Working Document accompanying the Clean Industrial Deal, (March 2023), link.

regulatory compliance, making energy more expensive, increasing pressure on the EU's competitiveness and reducing the sector's resilience in future crises due to increased liquidity pressure.

Enhancing data sharing between regulatory authorities through a dedicated data strategy

To strengthen market oversight and deepen market understanding, the Gas Market Task Force should prioritise ensuring that regulatory authorities have broader visibility over the market. Although energy market participants report extensive data under REMIT, EMIR, MiFID II and MiFIR, no single supervisory authority currently appears to have a complete view of the market. According to the Frontier study[6], the core issue does not lie in lack of reported data but in the challenge of ensuring proper data-sharing between authorities.

In this context, we recommend the adoption of a clear **data strategy** that: (i) pauses changes to existing reporting requirements, (ii) evaluates what is currently reported, what is needed from each regulatory objective and what is missing or redundant from this perspective, and (iii) explores the development of a central data collection mechanism[7] or interoperable data-sharing framework that enables secure access to and exchange existing reports among authorities. Such an approach will, for example, allow energy regulators to access EMIR data, while giving financial regulators greater transparency into non-financial products, alleviating concerns that the current delineation between financial and non-financial products (the"C6-carve-out" or "REMIT carve-out") is not appropriate. Importantly, regulatory authorities could leverage the technical solutions already used by many energy market participants to consolidate data for trade surveillance. By integrating existing reports and other relevant data feeds into a shared platform, authorities could obtain a more comprehensive market view without increasing the reporting burden on market participants.

Setting up a collaborative platform for regulatory authorities

To operationalise the data strategy and ensure cross-sectoral coordination, we propose establishing a **Platform for Cooperation** that brings together ESMA & ACER, and NCAs & NRAs where needed. While maintaining the current powers for these authorities, the Platform for Cooperation's core tasks would include: implementing the above-mentioned data strategy, exploring opportunities to conduct joint market studies and define crisis response protocols, enabling rotations and secondment within authorities, facilitating strategic dialogue and providing a forum for cross-sectoral discussions on major investigations, where appropriate. There are already successful regional practices that can serve as inspiration[8]. The benefits would be significant: a more consistent and coordinated EU approach to oversight, better use of existing data without duplication and better informed regulatory responses.

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[6] Principles Of Energy Market Regulation – Securing Efficient & Resilient Energy Trading, (April 2024), Frontier Economics and Luther Law Firm, link

[7] i.e. a single, centralised point of access for regulators to data reported to various different data repositories by market participants

[8] An example is the European Supervisory Authorities, which consists of the European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA).

What Should Not Be Done

Changing the current position limits regime

Only four years ago, the EU position limits regime was reviewed to make it a more flexible and effective tool for addressing concentration risks. While the largest EU energy contracts remain subject to position limits, trading venues also apply position management controls to physically settled contracts. There is no evidence that a further review is warranted, nor which regulatory goals should be pursued by such review.

Reintroducing price limits such as the Market Correction Mechanism

The ECB warned that the Market Correction Mechanism (MCM) "*may, in some circumstances, jeopardise financial stability in the euro area*".[9] This is an important and accurate statement. Price caps such as the MCM, but also static circuit breakers, which prevent market participants from trading at prices that reflect market fundamentals, undermine companies' ability to manage risk effectively. As a result, they may choose to trade outside the EU, and ultimately beyond the EU's regulatory oversight.

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[9] Opinion on a proposal for a Council regulation establishing a market correction mechanism to protect citizens and the economy against excessively high prices (CON/2022/44), (December 2022), European Central Bank, link