

Deutsche Börse Group, EEX Group, Powernext
Response

to the Commission's targeted consultation
on the role of the euro in the field of energy

Brussels, Frankfurt, Paris, 31 March 2019

1. Introduction

We welcome the Communication by the European Commission “Towards a stronger international role of the Euro” and very much appreciate the opportunity to respond to the consultations in that respect.

As a Euro-area based integrated provider of financial market infrastructures, Deutsche Börse Group (DBG) covers a variety of products from energy and agricultural commodity markets to foreign exchange (FX). DBG is the fourth largest exchange organisation by market capitalisation globally and our services include the processing throughout the entire value chain from listing to clearing and settlement. In this context, DBG has followed with great interest the recent European Commission’s initiative to further strengthen financial integration and to explore ways to support the role of the euro at the international level.

Strengthening the international role of the single currency may be done through different paths – directly, by increasing the trust and attractiveness of the currency itself; and indirectly, by supporting products and services denominated in euro as well as the Eurozone’s financial ecosystem. Given the complexity and potential cross-feeds of such dynamics, we appreciate the European Commission’s approach to collect and gather feedback from a variety of sectors and actors to better understand the mechanisms at hand. Against this background, we would like to highlight that DBG contributes to the following consultations and would welcome if the subsequent comments will be understood in the general aim to achieve the intended outcome as described above:

- Consultation on the role of the euro in the field of energy
- Consultation on the role of the euro in international trade of agriculture and food commodities
- Consultation on market liquidity in foreign exchange markets

2. Introductory Remarks on the Consultation on the role of the Euro in the field of Energy

The European Energy Exchange Group (EEX Group) is the commodity branch of DBG. EEX Group runs markets in Europe, Asia and North America and is home to trading in different currencies. This is why making decisions on whether to launch a new EEX Group contract denominated in euro or in another currency is part of our everyday business. EEX Group’s offering comprises markets for energy, agriculture, freight, metals, and environmentals, including the EU Emissions Trading Scheme. EEX Group has become the largest Electricity Exchange in the world. In 2018, 4,962 TWh power were traded, which corresponds to nearly nine times the electricity consumption in Germany in that year.

Powernext is the Natural Gas branch of EEX Group. It runs PEGAS, the central gas trading platform of EEX Group, providing its members with access to all contracts in the Austrian, Belgian, Czech, Danish, Dutch, French, German, Italian and UK gas market areas. The integrated group portfolio is completed by two clearing houses which ensure the proper clearing of these transactions. Nodal Clear is based in the U.S., and the European Commodity Clearing (ECC) is located in Germany.

In Europe EEX Group is part of a diversified landscape of energy exchanges and market operators. Having an EU-based energy commodity trading sector is pivotal for the European economy as a whole. This is true in particular as the industry is going through a fundamental transformation and consolidation process, with a growing division between globally and foremost regionally operating trading venues. It is therefore important to foster the further development of this industry in Europe because it can also help to increase the role of the euro as a denominating currency and can avoid the lock-in of trading into non-European infrastructure exposed to third-country influence.

The European Commission in its Communication carefully notes that *“the decision to use a currency is ultimately made by market participants and there are good reasons why economic actors might wish to invest and hedge in different currencies. The objective is not to interfere in commercial freedom or limit choice, but rather to expand the choice for market participants by ensuring that the euro represents a strong and reliable alternative in all relevant ways.”*

While we agree with this statement, we believe that the EU can play a vital role in creating the regulatory framework that promotes new contracts denominated in euro and fosters the liquidity in contracts that are already denominated in euro. In this context, we aim to provide some key insights into the dynamics we observe in the global energy market and the potential of the euro to serve as an underlying in the field of energy both for existing contracts and for new global markets which are about to emerge.

3. Market Dynamics and Potential for more Euro-denominated Products

First of all, we recognise the dominant role of the US dollar for trading oil contracts. Historical inertia, network effects and liquidity are assumed to be the main reasons for the euro to be only of marginal use in this area. However for gas, the situation is different. Although 70% of EU imports are referenced in US dollar, the European gas trading hubs are typically denominated in euro and have grown significantly over the last couple of years. For example, the Dutch TTF and British NBP gas hubs have become reliable European benchmarks and also smaller gas markets in Europe are seeing progress.

However, due to its progressive liberalisation and the ambitious climate action objectives set by the EU, the energy market is rapidly changing. There are new technologies that have the potential for the EU to become less dependent on pipeline imports.

Particularly three areas – each at a different level of development – we believe should be closely monitored and promoted, for their potential of achieving the EU energy and climate objectives, their potential to become global commodities and hence to promote the euro as a denominating currency: Liquefied Natural Gas (LNG), hydrogen- and emission markets.

a. Liquefied Natural Gas (LNG)

Natural gas is a key commodity in today's global energy mix. The transport of natural gas via pipelines still accounts for the largest share of global gas trade. The largest exporter via pipeline is Russia, which exports so far mainly to Europe. One way to diversify and to increase Europe's security of supply is the use of LNG. Following its liberalisation, the volume of LNG traded globally is continuously growing. Due to the ease with which LNG can be transported, it has become a real commoditized market. By performing the role of virtual pipelines, it is connecting the US, European and Asian regional markets and has literally been the driving force behind global natural gas trade.

This trend has been accompanied by infrastructure investments in regasification capacity. The rising importance of LNG across global trade routes will further increase international competition and create a different type of interdependency, potentially on a larger scale than that arising from pipeline trade between two states.

Today LNG is mostly traded in US dollar (e.g. the Japan-Korea-Marker index/ Platts JKM® is denominated in US dollar). Because of its growing infrastructure and virtual trading hubs, Europe will become more important for the price formation in the global natural gas market. LNG will stimulate trading in Europe and strengthen local markets and indices, leading to a further decline in the oil indexation of natural gas contracts. That development in itself has helped to improve the role of the euro as the trading of natural gas contracts in continental Europe is mainly in euro.

Powernext will launch a financially settled LNG contract in the first half of 2019 on its trading platform PEGAS, expanding its extensive European offering for spot and futures gas trading with a globally traded commodity. In recent years, the market for LNG has grown significantly enabling Powernext to offer such a standardized product which helps companies to hedge their cargos and optimize their portfolios. The Powernext offering will comprise the registration of LNG futures for clearing, which are financially settled against Platts JKM®, denominated in euro.

However, as the European market is large enough, we believe that there is the potential for a European LNG index – related to the TTF hub – denominated in euro.

b. Power-to-X, Hydrogen Markets

The global energy system needs to fundamentally transform towards carbon-neutral energy sources over the next decades to meet the long-term goals set in the Paris Agreement. The energy transition towards carbon-neutrality is based on a number of key elements such as increasing the efficiencies of energy applications, boosting the supply of renewable energy sources (RES), and deploying other forms of carbon-neutral technologies. Synthetic fuels and hydrogen produced from renewable electricity (Power-to-X or PtX) could play an important role in the future.

Hydrogen might become a new global commodity which according to the World Energy Council can be significant in size, driving substantial investments. Indicative estimations illustrate that a mature global market for green synthetic fuels can easily demand between 10,000 TWh/a to 20,000 TWh/a in the long term (2050 and beyond).¹ This corresponds to around 50% of today's global demand for crude oil. The required capacity for water electrolyzers (producing hydrogen) alone can reach between 3,000 GW to 6,000 GW. A future global hydrogen market will be sizeable, as even a partial materialisation of this indicative global hydrogen market potential requires significant investments in PtX technologies and plants over the next decades. These investments will need an adequate regulatory framework and early action, paving the way towards a global PtX industry. There is a large number of potential hydrogen producing countries. However, whether and when they enter the market depends on individual motivations. A global hydrogen market could be supplied by many potential hydrogen producing countries from across the world.

We welcome the strong political commitment in Europe to the development of hydrogen markets. In September 2018, the Council of the European Union launched the "Linz Hydrogen Initiative" aiming to raise political awareness on the potential role of hydrogen as an energy storage solution as well as a sustainable climate neutral energy carrier and feedstock. This commitment is to be reinforced in the "Bucharest Declaration" of April 2019, with Member States committing to analyse the potential of hydrogen for a future decarbonised energy system.

Hydrogen might become a new global commodity with the potential of being denominated in euro. When reflecting about the future energy supply and the role of the euro, Member States and the European Commission should elaborate further on that aspect.

c. Global Emissions Markets

Since the 2000's, there has been a trend with governments worldwide to put in place more ambitious policy targets for greenhouse gas emission reductions. Market mechanisms have long played a strong role in achieving these targets. The first large-scale market mechanism was the European Union Emissions Trading Scheme (EU ETS) launched in 2005, which is still the world's largest system in operation. Today, the EU ETS encompasses a wide range of sectors of the economy, covering more than 11,000 installations in 31 countries and nearly half of the EU's total greenhouse gas emissions (1.84bn t CO₂ equivalent). Entities included in the EU ETS are required to surrender EU Emission Allowances (EUA) for their emissions, with one EUA equalling one ton of carbon equivalent.

Reducing carbon emissions through emissions trading systems has created the need to trade a new commodity, i.e. emission allowances. This is a commodity where Europe clearly plays the world's leading role with EUA, which are denominated and traded fully in euro. The EU ETS is a mature financial market attracting a wide range of market actors. These include not only those with compliance obligations under the trading scheme, but a wide range of service providers such as financial institutions which facilitate trading and hedging. Europe's leading role is reflected in the liquidity and robustness of the market, which makes the EU ETS stand out from other systems.

Carbon trading volumes globally increased by 45% from 2017 to 2018. In 2018, a total of 9.1bn carbon permits was traded globally, with the EU ETS accounting for 90% of their total value and more than 75% of total volumes. Driven by the adoption of the EU ETS policy framework for 2021-2030, prices in the EU ETS tripled from 8 to 25 euros during this year. Globally, 21 emissions trading schemes are in place at the moment in countries which together represent more than half of world GDP.

This competitive advantage of Europe in carbon trading means that emission allowances can potentially play an important role in strengthening the global role of the euro. Governments worldwide are increasingly rolling out emissions trading schemes, taking the EU ETS as a role model. While such regulatory similarity will make it easier for European companies to enter these markets, these countries could also chose to denominate their emission trading systems in euro as a precondition for a further integrated global emission allowance markets.

¹ Study by World Energy Council "International aspects of a power to x roadmap: https://www.weltenergieerat.de/wp-content/uploads/2018/10/20181018_WEC_Germany_PT roadmap_Full-study-englisch.pdf

Such integration can take different forms, ranging up to a full 'linking' of schemes, meaning connecting several markets to form one, large, market. Several successful initiatives already exist, such as the Québec-California-Ontario link or the Swiss-EU link which is in preparation.

In addition, global negotiations are on-going on the introduction of global market measures for the aviation and maritime sectors. Potential future global emissions trading schemes for these sectors would cover a significant emissions volume and offer great potential for further strengthening the role of the euro in this field, if such markets were traded in euro.

In sum, the EU ETS as the world's leading carbon trading scheme offers great potential to expand the euro's role in commodity trading.

4. Market-Oriented Energy Policy & Financial Regulatory Framework

For both promoting new contracts in euro and fostering liquidity in contracts that are already denominated in euro, it is key to that the Eurozone as such is attractive for market participants and its regulatory framework is fit for purpose: At the moment the framework rather weakens competitiveness of European commodity markets vis-a-vis global markets. Regulatory complexity is an impediment to trading for many market players. In the following section we focus on topics we deem to be key for the regulatory framework to become more attractive to market participants.

a. Large and Liquid Market Areas for Electricity strengthen the Role of the Euro

Wholesale electricity markets are the basis for end consumer prices in Europe. They provide hedging possibilities and investment signals for the industry. Energy exchanges in the EU, running wholesale markets, were created in the wake of the liberalisation of the energy sector (as of 1998). Since then, they have significantly contributed to competitive markets and clear, resilient and transparent price signals. Contracts on spot and derivatives markets are traded by market participants from Europe and beyond. EEX Group e.g. connects more than 600 market participants from 36 countries. In 2018, total power trade on across EEX markets was 4,386 TWh on derivatives/forward markets and 577 TWh on spot markets. As a comparison, physical power consumption in Germany amounted to approximately 550 TWh in 2018. From the beginning, these markets have been denominated in euro. That means that further developing these markets also strengthens the role of the euro.

Pivotal in this respect is the geographical outline of electricity markets in Europe. They are determined by distinct market areas ("bidding zones"), in which a wide range of market participants (e.g. utilities, energy intensive industries, financial players) trade - thus fostering liquidity. The entirety of these (coupled) markets constitutes the Internal Energy Market (IEM).

For many years discussions are going on whether and how these bidding zones need to be reconfigured. And while experience has shown that bidding zones which are large and stable over time are beneficial for the development of trading liquidity, the number and heterogeneity of market participants, as well as the standardisation of products and processes, these aspects have not been adequately taken into consideration in the debate.

Recently adopted by the EU, the Clean Energy Package changes the rules. It explicitly calls on market places, such as exchanges to continue developing new products for the energy market of the future, and it recognizes the role of long-term markets to deliver the energy transition.

The fundamental importance of short and long-term markets has to be reflected in assessing bidding zone design. Connected to this, the impact on the euro as the denominating currency for electricity wholesale markets in Europe should also be considered.

b. The MiFIR Pre-trade Transparency Regime

EEX and other European exchanges have long argued that the MiFIR pre-trade transparency regime in its present form is not fit for purpose for commodities. It may prevent pre-arranged trades from being submitted to exchanges, thereby limiting the ability of market participants to hedge their commercial exposures. Moreover, if market participants are no

longer able to submit pre-arranged trades to exchanges, i.e. what we call “trade registration”, they may be forced to move trading activity to the non-cleared OTC space. This will limit transparency and undermine the price discovery process as well as limit the possibility of physical delivery to take place under the exchange / clearing house rules, hence going against the spirit of the G20 reforms. This is because, compared with other financial instruments in Europe, almost all European commodity markets are less liquid. As explained above, in order to achieve execution, market participants often trade via brokers organizing transactions through a pre-arranged agreement rather than in a central order book where a satisfactory execution would be less likely.

It is important to realize that because of trade registration, more and more traders find their way to the central order book. Trade registration has been and still is essential to – as a next step – bring more volumes to the central order book.

In order to promote liquidity of European commodity markets, the pre-trade transparency regime should be better tailored to commodities, including energy derivatives, and allow for a more natural move to central order book trading.

c. The MiFID II Position Limits Regime

With the entry into force of MiFID II, every commodity derivative contract in Europe has become subject to a position limit on the size of a net position that a person can hold at all times in this contract. The limits, which aim at preventing market squeezing, are set as a percentage of the deliverable supply available in the underlying physical market with regards to spot month contracts and a percentage of open interest with regards to contracts expiring in all other months. Furthermore, Article 15 of RTS 21 has introduced a specific regime for new and illiquid contracts whereby a fixed limit of 2,500 lots is set for all months in contracts not exceeding 10,000 lots of open interest. In addition, contracts up to 20,000 lots of open interest are eligible for a higher percentage limit of up to 40% of deliverable supply in spot month and open interest in other months.

While the MiFID II position limits regime has so far been able to function in a reasonable manner for a number of well-developed benchmark contracts, which are characterized by a large number of different types of active trading firms and an overall substantial amount of open interest, for the development of new products and further growth of the existing illiquid commodity derivative markets, the position limits regime has proven to be a substantial barrier. Fast growing markets in particular have suffered from (1) an increasingly restrictive limit as open interest increases, (2) an inflexible treatment in terms of their categorization under the position limits framework and 3) an inaccurate reflection of the underlying physical markets.

As we believe that a proportionate and efficient position limits regime should concentrate on a limited number of benchmark contracts, similar to the way the U.S. has developed its position limits regime, we recommend that position limits on new and less liquid contracts (i.e. contracts up to 20,000 lots open interest) are suspended for an interim period to allow them to develop. Such an approach would provide the necessary flexibility allowing fast-growing markets to thrive and thus the development of new products is not restricted by disproportionately low position limits.

d. The Complexity of Supervisory Reporting Requirements

The further obstacle for improving liquidity of euro-denominated contracts is the complexity of the supervisory reporting framework. For energy derivatives, tailor made energy-only regimes coexist with reporting solutions requirements primarily designed for non-commodity financial services. With the go-live of MiFID II, these contracts are covered by reporting obligations stemming from five pieces of legislation, namely: EMIR, MiFID II, MiFIR, REMIT and MAR. As a result, overlapping data reporting requirements for essentially the same data, different reporting formats as well as a variety of submission technologies and target entities have developed in parallel with little to no coordination between them. See table below.

Overlapping reporting requirements for energy trading

	EMIR	REMIT	MiFID II/MIFIR	MAR
Transactions	✓	✓	✓	-
Orders	-	✓	-*	-
Reference Data	-	-	✓	✓
Positions	✓	-	✓	-
Exposures	✓	-	-	-
Spot	-	✓	-	-
Derivatives	✓**	✓	✓**	✓**
Power & Natural Gas	✓	✓	✓	✓
Other commodities	✓	-	✓	✓

*Only record-keeping and pre-trade transparency required **For regulated markets only

In order for the sector to continue being attractive, there is a pressing need to streamline these supervisory reporting requirements by avoid double reporting and reducing the number of entities that should be receiving the reports.

5. Conclusion

To conclude, DBG and its entities would like to welcome once again the European Commission's approach to collect and gather feedback from a variety of sectors and actors to better understand the mechanisms which underpin the use of the single currency. DBG very much hopes that this response will serve as first step to provide a holistic understanding of the various factors at play in the field of agricultural commodities.

In this context, DBG and its entities will continue to follow with great interest the European Commission's initiative to support the role of the euro at the international level. We stand ready to further support the European Commission's objectives to strengthen the European markets and Europe's financial ecosystem in this context, including creating competitive energy commodity markets. DBG remains available for any questions and additional feedback on potential future propositions.