

The impact of Brexit on energy trading



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Agenda:

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- 2. The “no-deal” Brexit scenario**
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 - i. MiFID II: C6 carve-out, ancillary activities exemption**
 - ii. REMIT**
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1. Brexit timeline

- **23 June 2016:** UK votes to leave the EU (51.9% leave vs. 48.1% remain)
- **29 March 2017:** Article 50 is triggered - UK expected to leave the EU on 29 March 2019
- 26 June 2017: the UK and EU begin formal Brexit negotiations begin
- **25 November 2018:** EU leaders approve Withdrawal Agreement & Political Declaration
- January - March 2019: PM loses 'meaningful vote' three times
- **21 March 2018:** EU27 leaders agreed to grant an extension: 22 May 2019 if deal approved by MPs; or 12 April 2019 if no agreement in the House of Commons.
- **10 April 2019:** the UK and EU27 agreed to extend Article 50 until 31 October 2019
- 7 June 2019: PM steps down and leadership contest begins

What happens next?

- 22 July 2019: new PM appointed during this week
- **31 October 2019**: UK leaves the EU unless further extension agreed or revocation.

- Following latest Article 50 extension, the UK is due to leave the EU:
 - By the 31 October 2019, at the latest; or
 - On 1st of the month (before 31 October) if the House of Commons ratifies the Withdrawal Agreement.
- As with other parts of the EU Exit process, the final date may be subject to political uncertainty and change in both the UK and EU
- No-deal Brexit is still the default outcome if no consensus on Withdrawal Agreement and no further extensions by 31 October.
- This means the UK would immediately (i.e. with no transition period) leave the EU with no agreement about the "divorce" process
- Both the UK and EU have taken steps to ease the possible burden of a no-deal scenario.

- No-deal preparations:
 - BEIS laid energy specific SIs - transferring functions to the UK
 - Ofgem sought feedback on licences and codes, interconnector Access Rules and two letters on REMIT
 - ACER and ESMA's public statements
- Main concerns of no-deal for energy markets:
 - Overall readiness: customs, tariffs, legislation, IT systems, etc.
 - Cost pressure on energy bills (duties, exchange rates, delays, etc)
 - Commodity trading: disruption to trade, UK platforms get third country status
 - REMIT: re-registration, reporting, readiness
 - Carbon pricing (EU ETS)
 - Other concerns: security of supply, labour mobility, etc.

3(i). MiFID II - Scope of Financial Instruments

1) MiFID II “C(6) carve-out”

- Paragraph C6 of MiFID II Annex I Section C defines when a physical forward traded on a venue is a “financial instrument”.
 - The “carve out” excludes any wholesale energy product that must be physically settled traded on an Organised Trading Facility (OTF).
- To be eligible to the C6 exemption and *not* to be considered as a financial instrument, a derivative contract must meet three conditions:
 - i. it must qualify as a “wholesale energy product”
 - ii. it must be traded on an OTF; and
 - iii. it must be physically settled.
- ESMA’s statement on 7 March 2019 implies that where a contract refers to UK delivered energy, it would no longer benefit from the carve out **in case of no-deal**:
 - i. electricity and gas derivatives exclusively produced, traded and delivered in the UK would no longer qualify as “wholesale energy product” as defined in REMIT, even if traded on an EU27 OTF
 - ii. exemption will only apply to derivatives traded on EU27 OTFs
 - iii. third condition unaffected.

3(i). MiFID II - Scope of Financial Instruments

➔ Electricity and gas derivatives no longer eligible to the C6 carve-out under MiFID II may become financial instruments if traded on EU OTF without meeting the REMIT definition.

However, ESMA also state "where, for instance, UK natural gas would continue to be traded on a spot trading platform in the EU27 post-Brexit, derivatives on UK natural gas would continue to qualify as "wholesale energy products" under Article 2(4) of REMIT and could benefit from the C(6) carve-out in MiFID II."

What happens in case of no-deal?

- UK OTFs will get third country status and thus contracts traded on UK OTFs will no longer benefit from the REMIT carve-out.
- Spot contracts will never be financial instruments
- *Will UK energy derivatives continue to benefit from the carve-out, provided that there is an operational spot market in the EU?*

UK OTFs are in the process of setting up an OTF in the EU

3(i). MiFID II – Ancillary activities exemption

2) Ancillary activities exemption

- Firms trading commodity derivatives on own account are exempt under MiFID II provided it is ancillary to its main business.
- Commodity traders are required to measure their own activity against total market sizes in commodity derivatives to assess whether they have to apply for authorisation as an investment firm.
- ESMA publishes estimation of the market size of commodity derivatives every year.

What happens in case of no-deal?

- ESMA's public statement in February 2019.
- Trading data from the UK will no longer be taken into account in determining the overall volume of trading undertaken in the EU.
 - EU firms will no longer have to consider trading done on UK venues in calculating the size of their own speculative positions.
 - Under UK MiFID II firms must continue to consider trading in the EU in determining their status.
- Calculations performed over a three-year rolling period preceding the date of calculation: UK data phased out of calculations gradually.

- In a no-deal scenario an amended Reg (EU) 1227/2011 on wholesale energy market transparency and integrity (REMIT) will come into force in the UK.
- Amended REMIT seeks to provide as much continuity as possible with EU, with concomitant obligations on Market Participants (MPs) trading GB wholesale energy products, and on Ofgem as national regulatory authority (NRA)
- Ofgem's no-deal REMIT contingency plan:
 - **Monitoring and enforcement** - Ofgem will continue to monitor and enforce GB wholesale energy as it does currently, using data collected from brokers and exchanges using existing domestic powers.
 - **Reporting** - Not establishing a 'Data Reporting System', from day one Brexit
 - **Registrations** -
 - Will establish and maintain a register of MPs by implementing a simple interim solution
 - Mitigating the extent of new registration requests to direct that MPs already registered with EU NRAs need not re-register with Ofgem
 - MPs registered with Ofgem who wish to trade EU wholesale energy products required to re-register with an EU NRA

3(iii). Other potential impacts – EU ETS

- Under the EU Emission Trading Scheme (EU ETS) industries with high carbon dioxide emissions, e.g. power plants, have to buy carbon allowances to cover their annual emissions (free allocations are still envisaged only for some industries). ‘Cap and trade’ principle:
 - Buy (additional) carbon credits in the market to surrender a number of allowances equal to previous year’s emissions; or
 - Pollute less by becoming more energy efficient/using cleaner burning fuels and sell surplus credits back into the market.
- The idea is to incentivise the move to cleaner fuels over time, with the number of carbon allowances available also gradually being reduced.
- UK is a significant actor in the carbon market, but moved away from coal in recent years.

What happens in case of no-deal?

- UK automatically leaves the EU ETS allowance trading system.
- No-deal scenario could theoretically bring 100 m tonnes worth of UK allowances back onto the EU market and dump the price of EU ETS carbon permits.
- Uncertainty, new carbon tax imposed upon UK companies participating in EU ETS.
- UK Government announced plans to implement an UK ETS linked to the EU ETS as long-term carbon solution.

Measures are being taken to ensure that wholesale energy market will continue to operate in case of no-deal Brexit

- **MiFID II - “C(6) carve-out”**

Uncertainty – potential disruption to trade if UK energy derivatives no longer meet the REMIT definition of wholesale energy product.

- **MiFID II - Ancillary activities exemption**

EU energy traders will need to consider their status under MiFID II to ensure they can still rely on the ancillary activities exemption.

- **REMIT**

Amended REMIT will come into force in the UK, ensuring as much continuity as possible with REMIT as it applies in the EU.

- **EU ETS**

Current uncertainty, but UK linked to EU ETS as LT choice announced.

Thank you for your attention

- Brexit timeline: <http://researchbriefings.files.parliament.uk/documents/CBP-7960/CBP-7960.pdf>
- ESMA70-155-7026 (5/2/19) - ancillary activity test: https://www.esma.europa.eu/sites/default/files/library/esma_70-155-7026_use_of_uk_data_in_esma_databases_in_case_of_a_no-deal_brexit.pdf
- ESMA70-155-7253 (7/3/19) – C(6) carve-out: https://www.esma.europa.eu/sites/default/files/library/esma70-155-7253_public_statement_mifidii_bmr_provisions_under_a_no_deal_brexit.pdf
- ACER's open letter on REMIT: https://documents.acer-remit.eu/wp-content/uploads/Open-Letter_Communication-on-REMIT-and-Brexit_190108.pdf
- Ofgem's first open letter on REMIT in no-deal scenario: https://www.ofgem.gov.uk/system/files/docs/2018/12/no-deal_eu_exit_remit_contingency_arrangements.pdf
- Ofgem's second open letter: <https://www.ofgem.gov.uk/ofgem-publications/148528>

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