

According to Steve Huhman, Vice President of Morgan Stanley, transparency is important but so too are legitimate claims to privacy.

Striking the Right Balance Between Transparency and Confidentiality

NOT QUITE A "PERFECT" MARKET

It is axiomatic that perfect markets exist only in the presence of perfect information. That is, all market participants have access to all data that influences the market. A corollary to this is that information has value. Individual market participants have a legitimate property right in any data that they might have generated. Furthermore, collection and release of data is not cost-free.

These facts create a regulatory "trade-off," i.e. how best to balance the push for "perfect" markets with the legitimate property rights of the participants, and costs to both participants and regulators? The answer usually lies in markets tolerating a moderate amount of market imperfection due to lack of perfect information, in return for the ability of regulators to monitor market behaviour in a manner that allows them to police abusive behaviour such as manipulation.

In other words, profiting from informational advantage is permitted, but profiting by using information or market position to manipulate prices or supplies, or impede competitors, is prohibited.

OPERATIONAL DATA

In discussions of transparency surrounding power and gas, there are two main categories. The first is operational information. The second is commercially sensitive information. Immediate transparency of operational information is crucial for competitive markets to function on a level playing field; in fact even to survive. Changes in system topology can have significant impacts on supplier costs, and even on the physical ability to fulfil contractual obligations. Key components that need to be communicated to all market participants as quickly as possible include

changes in physical status of generating units, both outages and returns; changes in availability or capacity of transmissions paths; and changes in forecasts of various sorts, including for load, maintenance schedules, outage repairs, etc.

Access to the knowledge needed to react quickly to changing operational parameters is crucial for making the necessary adjustments to minimize costs. Superior access to such knowledge provides a huge competitive advantage. It is therefore important for operational information to be made available as soon as possible. Otherwise, it is inevitable that the information will spread informally but unevenly, providing an unfair competitive advantage to those who have better access. Markets in which the participants do not trust that they will receive regular, prompt and accurate information about operating parameters, are very vulnerable to volatile swings due to rumours. While the rumour factor can never be completely eliminated, it can be minimized, saving a great deal of wasted effort devoted to confirming rumours. Ultimately, this results in much smoother operation, both physically and commercially.

COMMERCIAL DATA

With regard to commercially sensitive information, and specifically transaction data, the availability of this information to the market in disaggregated form does not have the same degree of urgency. The more important use of such data is in assisting regulators in the fulfilment of their duties. Without it, the ability to protect consumers from market manipulation can be significantly compromised. Release of this same information to the market in general, however, is more problematic. Doing so can provide insights into competitors' positions and

strategies, which would be viewed by most as legitimate proprietary information. It is Morgan Stanley's view that current European electricity and gas markets are not yet deep and liquid enough to allow release of individualised commercial data without causing unacceptable harm to market participants. For the foreseeable future, any commercial transactional data should be released only in aggregated form, to the extent a case can be made that such data provides competition enhancing benefits that exceed compliance costs.

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Decisions regarding commercial data transparency rules must also consider compliance costs relative to market benefits. Costs will accrue to both the market participants and to any regulatory body mandating and/or coordinating the data aggregation and release. For market participants that lack market power, the costs of the reporting exercise may not be justified. By definition, if they lack market power, then they are unlikely to be able to manipulate markets. The one exception, perhaps, is with respect to collusion, where individuals banding together could collectively create market power.

CONCLUSIONS

Any new data disclosure rules should take into account existing transaction recording and disclosure practices, in order to avoid potential duplication of efforts. In this context, it should be noted that MiFID currently waives reporting obligations of investment firms when the concerned transactions have been reported directly by a regulated market, an MTF or a trading system approved by the competent authority. Similarly, for physical power and gas markets, a large part of the transaction data can often be sourced directly from wholesale market entities, such as brokers and exchanges, even when the entities are unregulated. These options should be thoroughly investigated prior to imposing new reporting obligations directly on market participants.

Transparency is important, but legitimate claims to privacy exist as well. The preparation, collection and distribution of information are not without cost, and those costs should be factored into any decisions to add disclosure regulations. Only when the cost-benefit analysis clearly favours the contemplated regulation should it be implemented.