

Interview

Peter Reitz, CEO EEX: “We are a globally operating commodities exchange”

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The Leipzig-based European Energy Exchange (EEX) is one of Deutsche Börse’s strongest growth drivers. Over the last years its turnover has multiplied, partly thanks to acquisitions. Peter Reitz, CEO of the energy exchange that has grown its business both geographically and by products offered, is certain that the high growth rates of the past can be maintained.

Mr Reitz, can EEX keep up its impressive growth of the past years or is it already at the peak of its success?

We do not think that we have reached the peak. Yes, 2018 was a further record year and we have made great advances over the years. In 2010 and 2011 we had over €40 million turnover and last year it was €268 million, but this is not the end of the line. The trend of the first months of this year mean that we are optimistic about the future. Trading volumes in our core business are well over the record volumes of 2018. This story will continue for a while, hopefully.

What are the drivers?

There are several drivers, a number of general trends that are continuing. In our core markets – the power and gas markets – trading still takes place over the counter (OTC) to a large extent without being cleared. This is now moving towards our platforms in so far as trading transactions are being registered on exchange for clearing. Trading in this business is becoming more professional and, in particular, risk awareness is growing. We remove default risk from the market and that is becoming increasingly important.

Is this true of all your asset and product classes?

This is particularly true of the power and gas markets, our two really big markets. We are succeeding in shifting volume from the off-exchange, uncleared market to the exchange and to clearing. This is happening in all our core markets but at different speeds. In the Italian market, for example, we had almost no business four years ago. Today the percentage of the cleared business transferred to our platform and our clearing house ECC especially stands at over 80 per cent. In other markets such as Germany, which is the biggest European market by far, we have a market share of around 40 per cent. This shows that the shift is taking place more slowly, but also that there is clearly room for growth. I expect this trend to continue.

Central clearing also has the advantage of being anonymous.

That plays a part and is also due to the mix of market participants. Over the last years we have expanded our participant network again and again. It is no longer just the large producers and large consumers that participate in trading but also hedge funds in the commodity space, for example, that are interested in anonymity and protecting themselves from default risk. But we have also won smaller participants to our core markets. For them it is important that they do not have to set up framework agreements with each single market participant on their own.

How is clearing developing in the gas market?

Gas market trading, especially in derivatives, is still off-exchange and uncleared. Market structures are only changing slowly. One factor, also true for power markets, which is pushing trading towards clearing is the change in the supplier structure. The market is becoming more decentralised, we have a lot of new participants, mostly smaller ones. When these make a move on-exchange where, in one fell swoop, they can trade with 600 other participants, it becomes much more attractive for them.

What about other activities in the gas market, are these also growth areas?

We see that particularly in the short-term gas market volumes are shifting to our platform. Our customers appreciate being able to trade different markets on one platform and we are expanding our offering here. For example, we have recently added the Spanish market. This geographical expansion is true for the gas, power and emissions markets.

EEX penetrated the US market with the acquisition of the US power exchange Nodal. Why?

We took over Nodal as part of our strategy to position ourselves as a globally active company in a global market. Over and above this, the US market is one of the largest in the world. Nodal was a good match and it has its own US clearing house. Nodal strengthens the global position of the EEX Group and, through one take-over, we are part of one of the most attractive markets in the world, due to its size.

How is Nodal's business developing?

Very well. We have very high growth rates, it is one of our most strongly growing business areas, both in 2018 and this year. Last year we saw a growth in turnover of over 24 per cent, this year it is over 80 per cent. More than a third of trading in the North American power market takes place on Nodal. It is no longer a niche player but has a significant market share.

How large is the cleared portion in the USA?

In contrast to Europe there are no figures for the uncleared market in the USA. The lion's share of the market there takes place on-exchange and via clearing houses. There are no figures for the off-exchange market, but it is a lot smaller than here in Europe.

Do you think that you will be able to grow your market share further? After all, the US market has a completely different set-up the European one.

Indeed, it is completely different. That is one of the big advantages that Nodal has there. There are no large price zones in the USA, in comparison to Germany or Europe, where they normally coincide with national boundaries. The USA has very small price points, which are individually priced, and Nodal has a very sophisticated system that allows it to offer up to 1,000 different contracts concurrently. This gives it a clear competitive advantage over other providers. Nodal can better address the risks that physical participants, i.e. manufacturers and producers, face, because it has a much wider offering for these small trade points, the so-called nodes. We are also trying to open up completely new business areas in the USA, such as futures for trucking freight, as there is also a need for the hedging of price risks here.

Which growth opportunities do you see in Asia now that you have reorganised your business in the region to Singapore?

In general, geographic expansion of our business is a core part of our growth. We are good at operating power and gas markets, along with emissions markets. We have new opportunities wherever they are set up. Asia is one building brick, but that is also true of other markets, for example in Europe where we have just added new markets in Bulgaria, Slovenia and Serbia. We are keeping a keen eye on Asia and looking closely at where the regulatory environment is best suited to develop power markets. Whenever we see a business opportunity in our core competencies, we take it.

What do you mean exactly?

Let me give you an example. The gas market is dependent on pipelines. With LNG – liquid natural gas – a global element is added as the market becomes interlinked through tankers carrying LNG that are underway across the globe. For this reason, we launched a new contract for liquid gas, and Asia is the big market here. Japan and South Korea especially are two of the largest consumers. We first need to get the contract established. This is a market for the long run. However, I believe that in the future LNG will also play a more important role in other regions across the world, such as in Europe.

In 2018 you also made headway in Singapore.

We received approval for a clearing house in Singapore. At present our focus in Singapore is on the freight business, but we don't want to stop there. Currently we are looking at the Japanese power market. From a regulatory point of view, it is where the European market was about 20 years ago, when regional monopolies were dismantled. This is the prerequisite for establishing a competitively organized power market. In particular, we are looking into whether it would, in the first instance, be possible to offer a clearing service for such a market.

Would you need a Japanese licence?

We are just clarifying which licences we need. We are in contact with the relevant authorities in Japan as well as, of course, our regulatory authorities in Europe. Initially we want to start purely with a clearing offering, which is normally the first step. We now have confirmation from the Ministry of the Economy, Trade and Industry (METI) that we may enter the Japanese market with our clearing offering for financially settled power contracts.

Are the Japanese so open?

We are confident in this respect. Up to now, we have seen wide interest from Japanese market. In addition, there are a multitude of international players, who are also active in the Japanese energy market and who are also to a large part admitted to EEX. This overlap strengthened our intention of developing a clearing offering of our own for the Japanese power market.

When can we expect to hear more?

I can't give you an exact date. We are aiming at a launch in the first half of 2020.

Are acquisitions still important and which areas would you focus on?

We have a pretty broad portfolio by now, even including an agricultural segment and we also cover freight markets. Our last acquisition was the purchase of the leading provider of energy certificate registries in Europe, a Finnish company called Grexel. We are convinced that this is a very good match for our power market portfolio as energy certificates, in other words the ecological quality of electricity, will play an increasingly important role in the power market. We have developed into a globally operating commodities exchange. When we find partners in this field, I am pretty sure that we would expand our portfolio further. I do not have any concrete names at present, but acquisitions have always been growth drivers for EEX and that is the way it will stay.

What is in the pipeline for emissions allowances? Would a CO₂ tax affect your market? What potential do you see in the emissions market?

The CO₂ market is an important pillar of our business; we are the auction platform for the whole of the EU (excluding Great Britain) for the initial issuance of EU emission allowances. This is an important mechanism to bring certificates into the market. We also organise the secondary market and the derivatives market for CO₂ certificates. However, the European system only covers about half of all emissions, so any expansion would be a step forward. No organisation in the world has more experience than us in organising such markets and we want to play a global role.

But wouldn't a CO₂ tax have adverse effects for EEX?

We are trying to address a global problem, namely the reduction of CO₂ emissions, via a market mechanism, and that is always the most efficient method. The ultimate goal is to have one global CO₂ price and for CO₂ to always be reduced where this is cheapest. We have not achieved this to

date. The European trading system is a good trailblazer, and across the world there are over 20 initiatives working on establishing such trading systems. We get involved wherever such systems are being developed so that these are built in such a way that they can be interconnected in the easiest way possible. All with the goal of having a global CO₂ price. We are not just active in Europe, but, with Nodal Exchange, we have also entered the North American market, which is still organised on a regional basis. There are other regional initiatives in other parts of the world, for example in China. Discussions are important. How can we get other sectors to take part in emissions trading in Europe, so that coverage can be increased from around 50 per cent at present to almost 100 per cent in the future? How can transportation and heating be given a CO₂ price. The most expedient way is always a market solution, always preferable to a tax, as it allows for quantity controls. Systems with quantitative controls are better suited to being interlinked and to thus reduce quantities in the most cost-efficient manner.

So, it is feasible that a global CO₂ price could be traded at EEX. What are the prerequisites?

This market evolved as a result of political declarations of intent. Unfortunately, such declarations of intent have not been issued in all parts of the world. I think we can foresee a global price for CO₂ coming about at some point, but it is unclear when this will happen.

What is your strategy concerning certificates for ecologically produced power?

It is no surprise that the market leader for such a registry is now part of EEX Group. All companies that issue or hold such guarantees of origin are connected to this registry. This is a growth segment. At present our focus is on the registry, but in the long run I think that a trading market will be established here. At the end of September, we will set up an auction in France for such guarantees of origin for the first time. This secondary market could also be processed on our platform. One problem is the lack of standardisation. It is difficult to make every single certificate individually tradable and develop the market in line with the needs of the market and its participants. Currently we are compiling the common denominator of such products.

EEX already offered such products, which the market did not adopt, such as Norwegian hydro-electric power.

Yes, Norwegian hydro-electric power is the biggest OTC market for guarantees of origin certificates, and German industry is the biggest customer, but the product offering is very fragmented. We are now looking into ways which would allow exchange trading.

Does French atomic power also count as green energy?

Certainly not within the category renewable energy. Guarantee of origin does not stop at green energy. Some countries are considering giving all electricity a guarantee of origin and letting consumers decide which type of electricity they want to use.

What are EEX's earnings here?

At the moment nothing as there is no exchange trading taking place. We do, however, run the registry and there are fees for that.

What are the regulatory guidelines for the over-the-counter market, what other influences are there on the market here?

This is a broad field: the commodities market is far removed from clearing obligations, unlike a clear majority of the financial markets. On the other hand, the markets are not so unlike. Risk awareness has increased, also as a result of the 2009 G20 summit in Pittsburgh. Elements of financial market regulation also apply to commodities markets, such as the Markets in Financial Instruments Directive (MiFID II). But not everything is a good fit for commodities markets. There are diverse regulatory obligations which also apply to our members. We help them to fulfil these, for example by taking on reporting obligations as a central service provider.

Can you rule out a clearing fund having to be tapped into to cover the total losses of a clearing member, as was the case at Nasdaq, for example?

We can entirely rule out a situation such as took place at Nasdaq. Our structure is completely different. It is the same as in the financial market where clearing banks act as guarantee for individual trading members and take on their clearing obligations. Individuals are not allowed to become clearing members at EEX. What happened at Nasdaq cannot happen here.

What is the role of blockchain solutions in your business, are you considering using this technology, for example in an increasingly decentralised power market?

Yes, that is just the field in which such solutions could become relevant. The structure of the power market sees us organising the wholesale market. This is where large consumers and distributors come together directly. The structural shift towards decentralised and smaller producers brings a number of changes. Regional markets develop. We also get involved here, because we are not concerned about whether we are dealing with a large wholesale market or a regional market. We also try to have an offering for the latter.

Meaning what, exactly?

Amongst others, we have a share in the B2B distribution platform Enermarket. What is important is linking markets in an intelligent way. If there is a need to balance a local market, we will do this, and if there are peaks that cannot be utilised, we will balance these in the wholesale market. But there is more to it than that, such as neighbourly support within individual streets in the context of micro-grids. We are also participating in a blockchain pilot project with partners such as Siemens and Centrica along with LO3Energy on this very micro-grid level.

Is this also interesting for the German market, which is characterised by capacity bottlenecks?

Most definitely, this is what we are just trying to develop. But capacity bottlenecks will not be eliminated by this means. They can be mitigated by trying to better align regional supply and demand. But without a massive extension of the grid – not just in Germany – the energy transition (Energiewende) will not succeed.

The EU has realigned the general framework for the power industry. What is your opinion of the European market? What are your activities here?

The Commission's Clean Energy Package is a huge step in the right direction, because it is not based on increasing subsidies or capacity markets but puts the emphasis on market mechanisms and the importance of price signals, thus strengthening the incentive effect of pricing. Markets in Europe are growing ever closer together, partly due to investments in transmission capacities at national borders. You can save a lot of money by not producing a local optimum but one that takes the whole system into consideration. We are very pleased, that is a good basis for the further development of the European market.

Christopher Kalbhenn and Dietegen Müller conducted the interview.