European Federation of Local Energy Companies
Confédération Européenne des Entreprises Locales d'Energie

CEDEC

European Parliament

Review of the Markets in Financial Instruments Directive

CEDEC Position

Identification number of CEDEC in the European Parliament / Commission transparency register: 54829912208-85

CEDEC represents the interests of local and regional energy companies.

CEDEC represents 2000 companies with a total turnover of 100 billion Euros, more than 250.000 employees, and serving 75 million electricity and gas customers & connections.

These predominantly medium-sized local and regional energy companies have developed activities as electricity and heat generators, electricity and gas distribution grid & metering operators, energy (services) suppliers and traders.

The wide range of services provided by local utility companies is reliable, environmentally compatible and affordable for the consumer. Through their high investments, they make a significant contribution to local and regional economic development.

Review of the Markets in Financial Instruments Directive

Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

The questionnaire takes as its starting point the Commission's proposals for MiFID/MiFIR 2 of 20 October 2011 (COM(2011)0652 and COM(2011)0656).

All interested stakeholders are invited to complete the questionnaire. You are invited to answer the following questions and to provide any detailed comments on specific Articles in the table below. Responses which are not provided in this format may not be reviewed.

Respondents to this questionnaire should be aware that responses may be published.

Please send your answers to econ-secretariat@europarl.europa.eu **by 13 January 2012.**

Theme	**Question**	**Answers**
Scope	1) Are the exemptions proposed in Directive Articles 2 and 3 appropriate? Are there ways in which more could be done to exempt corporate end users?	The exemptions are not appropriate because: - Energy trading companies deal on own account in financial instruments in order to be able (i) to offer their customers a demand-based, market-based, transparent and reasonably priced and competitive supply of energy, (ii) to reduce the risks of energy procurement and energy production, and (iii) to react promptly to volatile and changing market conditions. This also applies when trading is organised in municipal platforms solely for the customers of public utility companies. - The restricted exemptions limit the room for manoeuvre

		enjoyed by the group of energy supply companies mentioned above, which are state of the art to cope with the specifics and the volatility of the energy market and will most likely result in a reduction of those companies' competitiveness (also vis-à-vis banks engaged in energy trading) and in the final instance lead to a weakening of the competition on the energy markets as a whole. - The activities particularly of medium sized energy trading/supply companies pose a far lower systemic risk than banks and financial firms. This was the conclusion reached by CESR and CEBS in their October 2008 advice which was confirmed in July 2010[1]. Additionaly, one should take in to consideration, that the so named "medium-sized" companies do not fall under the scope of the definition of "SME" (small-and medium sized companies), as they are bigger than SME but still smaller than big companies in Europe or banks. - The extension of financial regulation bears the danger that medium sized energy companies would be tied to financial markets and institutions in a new way, leaving them far more exposed to a crisis in the financial world than before. Without appropriate exemptions for the above mentioned medium-sized energy supply companies, regional suppliers and public utilities, they will not be able to cope with the requirements of the MiFID and their related regulations . Free market access would likely only be available to a few major

[1] CESR-CEBS advice 15 Oct 2008 (CESR/08-752), see under: http://www.cebs.org/getdoc/ee9b85fa-4d64-48dc-9f45-a7350881ddac/2008-15-10-CESR-CEBS-advice-on-Commodities.aspx , confirmed in "CESR Technical Advice to the European Commission in the Context of the MiFID Review and Responses to the European Commission Request for Additional Information" – 29 July 2010

		companies who would be able to meet the related financial requirements, which would be the consequence of the application of MiFID. The consequence of this, however, would be that oligopoly-like structures might spring up once again from power generation all the way to the supply of the final customer and that previous endeavours to liberalise the energy market (promotion of competition, increase in the number of market players, reduction of the market power of a few individual companies, etc.) might be rendered futile. In that case, one would also have to expect rising and non-transparent prices for the supply of electricity and gas that affect customers and economic growth. It is therefore a matter of uttermost importance that the text of the exemptions for ancillary activities is clear and continues to be applicable in a legally secure manner for a significant group of energy suppliers and their procurement platforms at the level of the consortium. In particular the use of trading instruments for companies whose main line of business is the generation of energy and/ or the supply of energy to customers and other end-users should not be inhibited. It has to be noted that it is not merely the bigger European energy supply companies that would be covered by all the rules of the MiFID and linked regulations, but a large number of medium-sized companies, regional suppliers and public utilities. These companies have their own energy trading activities

		(integrated in the same company or outsourced in daughter companies) and would therefore also be fundamentally affected by the MiFID and linked regulations without being able to benefit from the special rules for the newly to be created sub-category of the so-called “SME growth market.” **See also our detailed comment including proposals for the revision of Art 2 below.**
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	No, it is not appropriate to include emission allowances: - emission allowances differ from financial instruments as they do not confer financial claims against the drawer of such allowances; - for energy companies emission allowances economically have the same function as fuels for power plants and not a derivative character - the inclusion of emission allowances into MiFID would cause a decreased liquidity on the trading market for such allowances, as the stricter requirements in the MiFID regime would limit the number of participants in such markets - trading with EUA’s would shift from its users (production) to banks who have a “secondary” interest in this business and only consider this market as an investment market and not a fuel market.
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	-
	4) Is it appropriate to regulate third country access to EU markets and, if so, what principles should be followed and	-

	what precedents should inform the approach and why?	
Corporate governance	5) What changes, if any, are needed to the new requirements on corporate governance for investment firms and trading venues in Directive Articles 9 and 48 and for data service providers in Directive Article 65 to ensure that they are proportionate and effective, and why?	-
Organisation of markets and trading	6) Is the Organised Trading Facility category appropriately defined and differentiated from other trading venues and from systematic internalisers in the proposal? If not, what changes are needed and why?	No, the OTF-category is not defined appropriately. In our point of view, OTF should be defined more specifically in MiFIR. "OTF" should be defined as an **automated system** (e.g. algorithmic trading), where a high amount of trades could be operated at once and where matched purchase and sales demands or orders are concluded automatically without a further activity of the companies.
	7) How should OTC trading be defined? Will the proposals, including the new OTF category, lead to the channelling of trades which are currently OTC onto organised venues and, if so, which type of venue?	OTC should be defined as every trade that is not operated via energy exchange, MTF or OTF (in due consideration of the "OTF"- definition regarding our comments to question 6.)
	8) How appropriately do the specific requirements related to algorithmic trading, direct electronic access and co-location in Directive Articles 17, 19, 20 and 51 address the risks involved?	-
	9) How appropriately do the requirements on resilience, contingency arrangements and business continuity arrangements in Directive Articles 18, 19, 20 and 51 address the risks involved?	-
	10) How appropriate are the requirements for investment firms	-

	to keep records of all trades on own account as well as for execution of client orders, and why?	
	11) What is your view of the requirement in Title V of the Regulation for specified derivatives to be traded on organised venues and are there any adjustments needed to make the requirement practical to apply?	-
	12) Will SME gain a better access to capital market through the introduction of an MTF SME growth market as foreseen in Article 35 of the Directive?	-
	13) Are the provisions on non-discriminatory access to market infrastructure and to benchmarks in Title VI sufficient to provide for effective competition between providers? If not, what else is needed and why? Do the proposals fit appropriately with EMIR?	-
	14) What is your view of the powers to impose position limits, alternative arrangements with equivalent effect or manage positions in relation to commodity derivatives or the underlying commodity? Are there any changes which could make the requirements easier to apply or less onerous in practice? Are there alternative approaches to protecting producers and consumers which could be considered as well or instead?	We oppose the introduction of "position limits" in MiFID and MiFIR for the following reasons: - Position limits reduce the liquidity in energy trading markets, while liquidity and therefore more competitiveness is one of the main purposes of current energy legislation - Position limits can lead to the situation that supply of end-customers is not possible or electricity cannot be sold while it is unavoidably produced in a cogeneration production of heat - Position limits would lead to the situation, that risks could eventually not be hedged - The definition of "position limits" is unclear
Investor	15) Are the new requirements in Directive Article 24 on	-

protection	independent advice and on portfolio management sufficient to protect investors from conflicts of interest in the provision of such services?	
	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	-
	17) What if any changes are needed to the scope of the best execution requirements in Directive Article 27 or to the supporting requirements on execution quality to ensure that best execution is achieved for clients without undue cost?	-
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	-
	19) Are any adjustments needed to the powers in the Regulation on product intervention to ensure appropriate protection of investors and market integrity without unduly damaging financial markets?	-
Transparency	20) Are any adjustments needed to the pre-trade transparency requirements for shares, depositary receipts, ETFs, certificates and similar in Regulation Articles 3, 4 and 13 to make them workable in practice? If so what changes are needed and why?	-
	21) Are any changes needed to the pre-trade transparency requirements in Regulation Articles 7, 8, 17 for all organised trading venues for bonds, structured products, emission allowances and derivatives to ensure they are appropriate to the different instruments? Which instruments are the highest priority for the introduction of pre-trade	-

	transparency requirements and why?	
	22) Are the pre-trade transparency requirements in Regulation Articles 7, 8 and 17 for trading venues for bonds, structured products, emission allowances and derivatives appropriate? How can there be appropriate calibration for each instrument? Will these proposals ensure the correct level of transparency?	-
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	-
	24) What is your view on the data service provider provisions (Articles 61 - 68 in MiFID), Consolidated Tape Provider (CTPs), Approved Reporting Mechanism (ARMs), Authorised Publication Authorities (APAs)?	-
	25) What changes if any are needed to the post-trade transparency requirements by trading venues and investment firms to ensure that market participants can access timely, reliable information at reasonable cost, and that competent authorities receive the right data?	-
Horizontal issues	26) How could better use be made of the European Supervisory Authorities, including the Joint Committee, in developing and implementing MiFID/MiFIR 2?	-
	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	-

	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	There are potential overlaps between parts of these legislative initiatives and this situation may lead to uncertainties for market participants/operators. EMIR (OTC Derivatives Regulation): The exemptions in Art. 2 Para 1 as stated in our comments to question 1 as well as in our detailed comments below are also important for EMIR. If a wide range of energy trading activities will be covered by MiFID, the important and undisputed differentiation between financial and non-financial companies made in Art. 7 of EMIR will become obsolete. In particular, we believe that MiFID should be based on provisions agreed in EMIR when defining rules for non-financial counterparties, otherwise the approach of the clearing threshold agreed in EMIR would be overtaken. REMIT Beyond the financial services, legislation interactions are foreseen with sector specific legislation in the energy market. In particular, the Regulation in Energy Market Integrity and Transparency (REMIT) recently entered into force that introduced a single oversight regime for gas and electricity markets and market participants across the entire EU. REMIT includes rules on registration of market participants, prohibition of insider dealing and market manipulation, transaction reporting, monitoring, and enforcement rules by National Regulatory Agencies supported by the Agency for Cooperation of Energy Regulators (ACER). We urge on the need to define clear boundaries between the legislation on discussion with a clear definition of their scope in order to avoid at any time that the same issue could be covered

		by several pieces of legislation. CRD (Capital Requirements Directive): If energy companies fall under the scope of MiFID, they will have to respect the severe requirements of CRD from 2015 onwards. This would lead to the situation that the above mentioned companies would either have to reduce their trading activities or would vanish from the marked. This although they don't constitute a systemic risk (see comment to question 1). In case they decide to fulfil the relevant financial requirements, the cost of these will be that high that will lead to exceptionally high energy prices.
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	In particular, we emphasise the rules concerning the energy sector included in the Dodd-Frank Act approved in the US. We strongly support a better specification of which derivative contracts should be considered financial instruments to exclude all products with delivery in the future that are physically settled. This is the approach used in the US under the Dodd-Frank Act, any departure from this approach in the EU would create regulatory inconsistency.
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	-
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	-

Detailed comments on specific articles of the draft Directive	
Article number	**Comments**
Article 2 Para.1 Fig. i)	According to Art. 2 Para. 1 Fig. i it shall be possible to provide in certain cases investment services (known in Germany as "financial services") without the need for a financial services provider's licence (bullet point 1 to bullet point 3), provided that the exempted activities are to be regarded as ancillary activities to the main business at company group level alongside a main business that is not itself the provision of an investment service. The intended sense and purpose of the revision of the MiFID is in particular an improved protection of the investors. This is why, in the assessment of the MiFID, financial services that are performed on one's own account are subject to less stringent requirements than those which are performed on behalf of third parties on a commissioned basis. This is correct insofar as the risks when acting on one's own account are borne not by the third party but by the provider of the financial service itself. However, the cases of exemption under the 1st and 3rd bullet point of Para. 1 Fig. i contradict this essentially correct assessment and thus result in the paradox that a commodity derivative for a client of one's main business – e.g. a gas customer – could be procured on that customer's account in the context of the exemption for ancillary activities, but that same commodity derivative could not be procured for the same customer on the energy supplying company's own account without falling under the scope of the MiFID. This results from the following considerations: • According to Art. 2 Para. 1 Fig. i, 3rd bullet point, persons are to be exempted from the scope of the MiFID who *"provide investment services,* ***other than dealing on own account****,"* in commodity derivatives or derivative contracts or emission allowances or derivatives thereof to the clients of their main business. Essentially that means that according to Art. 2 Para. 1 Fig. i, 3rd bullet point, commodity derivative transactions may be provided to clients of one's main business as an ancillary activity if these transactions are **not on one's own account**. • According to Art. 2 Para. 1 Fig. i, 1st bullet point, on the other hand, persons are to be exempted from the scope of the

MiFID, who *"deal **on own account** in financial instruments, excluding persons who deal on own account by executing client orders".* This means, however, that falling under the exemption for ancillary activities would be out of the question for persons who, when executing client orders, deal on their own account.

The above differentiation is particularly difficult to comprehend in connection with the statements in Recital 14 of the MiFID. In the last sentence of Recital 14 it is stated that, by way of exemption, *"the execution of orders in financial instruments as an ancillary activity between two persons whose main business, on a group basis, is neither the provision of investment services (…) should not be considered as dealing on own account by executing client orders."* According to this wording, it should therefore be possible for an energy supply company (main business: sale of gas) to sell to its client (main business: sale of gas) a hedging contract (e.g. to safeguard the current gas price), even if the energy supply company does this on its own account.

<u>This existing contradiction in the draft could be resolved in one of the below mentioned ways:</u>

Possible solution 1:

- By deleting the parenthesis ***"excluding persons who deal on own account by executing client orders"*** in Art. 2 Para.1 Fig. i, 1st bullet point **or**

- By deleting the parenthesis ***"other than dealing on own account"*** in Art. 2 Para.1 Fig. i, 3rd bullet point.

Proposal for the revision of Art 2 Para.1 Fig I according solution 1:

(i) persons who:
- *deal on own account in financial instruments, ~~excluding persons who deal on own account by executing client orders~~, or*
- *provide investment services, other than dealing on own account, exclusively for their parent undertakings, for their subsidiaries or for other subsidiaries of their parent undertakings, or*
- *provide investment services, other than dealing on own account, in commodity derivatives or derivative contracts included in Annex I, Section C 10 or emission allowances or derivatives thereof to the clients of their main business,*

	provided that in all cases this is an ancillary activity to their main business, when considered on a group basis, and that main business is not the provision of investment services within the meaning of this Directive or banking services under Directive 2006/48/EC **or** *(i) persons who:* *- deal on own account in financial instruments, excluding persons who deal on own account by executing client orders, or* *- provide investment services, other than dealing on own account, exclusively for their parent undertakings, for their subsidiaries or for other subsidiaries of their parent undertakings, or* *- provide investment services~~, other than dealing on own account~~, in commodity derivatives or derivative contracts included in Annex I, Section C 10 or emission allowances or derivatives thereof to the clients of their main business,* *provided that in all cases this is an ancillary activity to their main business, when considered on a group basis, and that main business is not the provision of investment services within the meaning of this Directive or banking services under Directive 2006/48/EC* **Possible solution 2:** - Amending the concept of “client orders” in Art. 2: The concept of "client orders” in the context of the phrase “execution of client orders” does not reappear in this form in the definitions (Art. 4). In Art. 4 Fig. 4 however, the “execution of orders on behalf of clients” is legally defined. For clarification purposes and to avoid the creation of unwanted room for interpretation, this concept should also be adopted in Art. 2.

	Proposal for the revision of Art 2 Para. 1 Fig I according solution 2: *(i) persons who:* *- deal on own account in financial instruments, excluding persons who deal on own account by executing client orders **on behalf of clients**, or* *- provide investment services, other than dealing on own account, exclusively for their parent undertakings, for their subsidiaries or for other subsidiaries of their parent undertakings, or* *- provide investment services, other than dealing on own account, in commodity derivatives or derivative contracts included in Annex I, Section C 10 or emission allowances or derivatives thereof to the clients of their main business,* *provided that in all cases this is an ancillary activity to their main business, when considered on a group basis, and that main business is not the provision of investment services within the meaning of this Directive or banking services under Directive 2006/48/EC* **In consequence Art. 2 Para: 1 Fig. d has to be amended in the same way:** *(d) persons who do not provide any investment services or activities other than dealing on own account unless they:* *(i) are market makers* *(ii) are a member of or a participant in a regulated market or MTF; or* *(iii) deal on own account by executing client orders **on behalf of clients**;* *(…)*
Proposals on the differentiation between legitimate, commercial risk-reducing hedging	Recital 88 enumerates criteria for hedging of business activities that are not to be covered by the regulation. We welcomes the fact that production-related hedging activities are explicitly mentioned; however, it notes that other cases of explicit hedging serve a necessary purpose of the main business: Energy companies use dealing on own account in financial instruments as a risk management strategy to limit or offset the probability of loss from fluctuations in prices changes in prices or changes in forecasted demands of commodities (Hedging). Hedging is especially used to:

activities and commodity speculation	- <u>Trade/hedging of sales portfolios</u> As a general rule, energy trading companies use commodity derivatives in order to minimize the risks of their sales portfolio A risk-minimized purchase of the sales-volume or the volumes according to client demands means that a sales plan and a trading strategy is set up for several tradeable years ahead that enables: o Price fluctuations to be mitigated by a portfolio o Reactions to price changes on the market o Reactions to changes of the sales forecast This approach should be seen as the most successful way to ensure that end-customers receive a well-priced energy supply. - <u>Trade/hedging of production portfolios</u> Energy companies use analogical portfolio-strategies for their production portfolio as above mentioned in respect of sales volumes. This has to be looked upon as a state of the art approach: A risk-minimisation makes it necessary to sell defined parts of the portfolio for several years in advance. Also in this case the option must be left to buy back already sold volumes if the market prices change. This would ensure a trustworthy portfolio optimisation that counteracts price fluctuations and helps to balance out extremes. - <u>Trading of the residual amounts required due to cascading in order to fulfil delivery commitments</u> An accurate purchase of forecasted sales volumes and an absolute accurate sale forecasted production volumes is impossible with the available trading products. It is impossible to trade short-term products during the years ahead. Therefore it is important to include under the wording of “hedging” the purchase of those volumes due to differences between forecasted sales and production volumes and those needed/produced at the time of delivery. As hedging is of utmost importance for energy companies, we therefore propose to reformulate recital 88 as follows, and we furthermore suggest to integrate the below definition of activities exempted from the scope of MiFID/MiFIR in the legal text, e.g. in the definitions of article 4 of the directive:

Recital 88	*"Considering the communiqué of G20 finance ministers and central bank governors of 15 April 2011 on ensuring that participants on commodity derivatives markets should be subject to appropriate regulation and supervision, the exemptions from Directive 2004/39/EC.for various participants active in commodity derivative markets should be modified to ensure that activities by firms, which are not part of a financial group, involving the hedging of production-related,* ***sales-related*** *and other risks as well as the provision of investment services in commodity or exotic derivatives on an ancillary basis to clients of the main business remain exempt, but that firms specialising in trading commodities and commodity derivatives are brought within this Directive."*
Article 4 Para 2 Fig 34 new	***"Commercial risk-reducing hedging activities" means in particular activities by firms, which are not part of a financial group, involving the hedging of production-related, sales-related and other risks as well as the provision of investment services in commodity or exotic derivatives on an ancillary basis to clients of their main business.***
Article 2 Para 3:	Art. 2, sec. 3, is intended to authorise the European Commission, by means of delegated legislation, to establish measures that can be used to determine the criteria for ancillary activities. Points are suggested that should be taken as a reference when making such determinations. The definition of the ancillary activities can determine which energy trading activities will be subject to supervision in the future and which will not, meaning that key areas of regulation are affected by the revision of the MiFID. Therefore, in addition to the already existing points, further criteria must be developed to ensure that the democratic principal of the EU is respected:
	The criteria for determining whether an activity is ancillary to the main business shall take into account ~~at least~~ the following elements: - *the extent to which the activity is objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity* - *the capital employed for carrying out the activity* ***or*** - ***the time and effort invested in the activity in relation to the overall company costs***

Article 2 Para 1 Fig. b)	For energy supply companies that trade in energy together with several other companies via a joint non-consolidated subsidiary, the proposed omission means that the "sector" exception for commodities and commodity derivatives in art. 2, sec. 1, paragraph k, is of greater relevance, as this can be used to evoke group structures in order to lay claim to an exemption. However, the definitions of "parent undertaking and subsidiary" in article 4, sec. 2 b) paragraph 24 and paragraph 25 are not sufficient here. These companies, which are typically founded by multiple shareholder clients to enable them to trade – not a realistic option economically as stand-alone entities, have not been granted an exceptional case in the draft MiFID, because in the absence of consolidation, neither the exception compliant to art. 2, sec. 1, paragraph b nor the exception compliant to paragraph i, point 2 are applicable. However, it is the type of securities services provided that should be the significant factor in determining the applicability of an exemption, and not the question of whether the subsidiary is developed via energy trading, or of whether it has a consolidated parent company or multiple (non-consolidated) shareholders. In the case of a joint company that trades as an ancillary activity for the main activity of the shareholder clients, an exception must be applicable if only one or none of the shareholder clients can consolidate the joint trading firm. **In order to ensure that an energy trading market remains solvent, it is necessary that non-consolidated companies are also covered by the exceptional case, insofar as the other conditions are fulfilled.**
Detailed comments on specific articles of the draft Regulation	
Article number	**Comments**
Article ... :	
Article ... :	
Article ... :	