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.

Name of the person/ organisation responding to the questionnaire	**RWE**

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?	Financial regulation is designed to protect investors in financial products and to insulate savers and taxpayers from the consequences of a financial crisis. While banks may sometimes trade commodities, corporate users of the commodity markets do not pose the same risks and concerns to taxpayers, investors and savers. It would not be appropriate to subject corporate users to the capital, clearing and licensing obligations that MIFID applies to financial firms. Any failure to retain proportionate exemptions for corporate users would force them to separate their risk management activities from their underlying commercial operations and to establish a separately licensed MIFID subsidiary. At best, this creates unnecessary organisational complexity, risk and cost,

		but at worst it undermines the wholesale market itself and carries the real risk that market participants decide to reintegrate physically along the supply/value chain to remove the additional costs and risks of dealing with wholesale markets at arms' length. With liquidity already fragile in many EU power and gas markets and with regulators actively pushing companies to stimulate further liquidity, the cumulative damage to European energy market liquidity, competition and consumers could be serious indeed. MIFID should therefore continue to provide exemptions for all commercial and industrial companies using derivatives in the course of their daily business of producing, buying, selling, supplying and consuming commodities. In this respect, the own account exemption (Article 2(d)) is unduly narrow. The exclusion of members or participants in regulated markets and MTFs would include virtually all corporate users and negate the benefit of this exemption. In particular, the exemption would not appear to be available for corporates whose business is the wholesale intermediation of physical commodities (eg, aggregators, cooperatives, merchant traders) who may use regulated markets to manage the risks inherent in the routine commercial activities of aggregating, disaggregating, warehousing and storing physical commodities. This risks bringing a significant portion of real-economy commerce under the umbrella of financial regulation with little attendant benefit to producers, consumers or investors. We therefore recommend that the "own account" exemption is broadened to include all non-financial companies trading on their own account providing that they do not trade algorithmically or provide investment services (other than trading on own account). Companies that have been encouraged or compelled by energy regulators to "market make", ie, to make energy available to third-parties – to establish or foster a wholesale market would also not be able to benefit from the own-account exemption as currently drafted. The market-making exclusion should therefore also be amended to carve out circumstances where such activity is the result of regulatory obligations elsewhere (as it has been for transmission companies).

		The "ancillary activity" exemption (Article 2.(i)) would appear to provide an appropriate exemption for many corporate users of derivatives, although much will depend on how ancillary activity is defined in the delegated acts. It would therefore be helpful to provide further clarity in the MIFID text itself on the criteria to be used in defining "ancillary" and specifically the text should include: • The presumption that firms trading commodity instruments for commercial purposes to manage commercial positions and price risks are exempt; • An activity threshold under which <u>any</u> trading of commodity instruments remains exempt. (This should, at a minimum, be set to preserve the benefit of the exemption under the OTC Derivatives Clearing Regulation, EMIR.) Finally, clarification is needed to ensure that the benefit of individual exemptions is not inadvertently negated by exclusions from other exemptions. (For example, to ensure that a firm can benefit from the ancillary exemption even if they fall within one of the exclusion from the own-account exemption.) This will require some amendment to the wording of the last sentence of Art. 2 (1) (d) to make this absolutely clear.
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	It is not appropriate to treat emissions allowances as financial instruments. EUAs do not share the legal or economic characteristics of financial instruments and their primary purpose is to allow non-financial firms to comply with their environmental obligations. While compliance buyers may benefit from MIFID exemptions, compliance buying consortia, cooperatives and intermediaries should also not be drawn within the net of financial regulation simply by virtue of their activities in sourcing physical allowances for compliance buyers. RWE is aware that many concerns have arisen in respect of emissions trading, but it is important to develop tailor made solutions to those problems rather than to reach for the blanket application of financial regulation to a non-financial market. Financial

		regulation would not have prevented the VAT fraud problems that arose in the allowance market and the recently revised Registries Regulation (29 November 2011) adequately addresses the problems with allowance theft. In respect of market conduct, well over 80 per cent of forward emissions trades already take place on regulated platforms and there is little practical benefit from extending regulation to the markets for allowances themselves. The designation of emissions allowances as financial instruments not only risks unduly extending financial regulation to commercial non-financial enterprises, but has significant potential for unintended consequences in terms of the accounting and tax treatment of allowance trades for compliance. There is unlikely to be sufficient time and attention during the course of the wider MIFID legislative process to adequately investigate and address these consequences. It would therefore be significantly more proportionate – and considerably quicker - to identify the residual concerns in the emissions market and to address these with a tailor made approach as has happened with the Regulation on Energy Market Integrity and Transparency in the power and gas markets. (Indeed, this was the conclusion of the French Prada Commission which called for the application of a regime similar to MAD and MIFID for emission allowances, but expressly excluded any re-qualification of emission allowances as a separate class of financial instruments.) In the event that MIFID nevertheless designates emissions allowances as financial instruments, the special features of EUAs and their primary compliance purpose should be recognised in the text by; • a specific exemption for firms to service their compliance requirements and optimise their compliance portfolio on an individual entity or group basis without such activities requiring a licence; and • the explicit disapplication of MIFID II provisions that are not proportionate or compatible with the sourcing and exchange of EUAs.

	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	RWE has no specific comments on this provision.
	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?	Yes, it is important to regulate third-country access to EU markets, but we would not want to see such provisions to become unduly burdensome or complex as to create an unwarranted and costly barrier to participation in EU markets.
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?	RWE has no comments on this question.
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?	The differentiation between Organised Trading Facilities (OTFs) and other trading venues appears clear. However, the consequences of extending MIFID's provisions to OTFs in the energy markets is considerably less clear and needs to be better understood. A large share of EU energy contracts – both physical and financial – are currently traded OTC on broker platforms and we are concerned that the combination of extending regulation to OTFs coupled with a shifting definition of financial (as opposed to physical) instruments could significantly extend the MIFID boundary in the energy markets and require the regulation of many previously exempt platforms and

		participants. Many of these markets are still in their relative infancy and the lack of liquidity requires specialised broker support and flexibility for trades to be successfully executed. Such services are not only an essential route to market for small players and new entrants, but in some cases, represent the very existence of the market in question, adding invaluable transparency to all market participants. In these circumstances, the imposition of financial market rules based on highly liquid global markets may not so much level the playing field, as erase the entire field of play completely. The European Commission's impact assessment failed to investigate and assess these impacts in detail and we would recommend significant further study and analysis in this area. The extension to new venues is of particular concern in the light of the narrowed own account exemption which removes the exemption for members of regulated markets. As highlighted this could bring many non-financial wholesale commodity intermediaries into the net of financial regulation without any justification. This provides further justification to broaden the own account exemption to all commercial firms who are neither algorithmic traders nor providers of investment services (other than dealing on own account).
	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 trading should continue to be defined, as now, as trading outside regulated markets. Crucially, however, MIFID needs to draw a much clearer distinction between physically settled OTC contracts and financial instruments to ensure that physical commodity transactions remain outside of MIFID. Physical settlement involves the delivery of power, gas and other commodities to a designated delivery point (eg, gas hub, price area or geographic location). Physical trades are fundamentally different to financial traders and do not pose wider risks to the financial markets. The consequences of including forward physical commodity trades within the boundary of MIFID are potentially huge if significant swathes of commercial activity become subject to forced margining, clearing and capital requirements. In energy, physical delivery also falls

		under the jurisdiction of the energy regulators, including the recently adopted Regulation on Energy Market Integrity and Transparency (REMIT). The US Dodd-Frank Act explicitly excludes physical forward transactions from the legislation and similar, proportionate treatment is required in the EU. MIFID should include an explicit clause to state that physically settled transactions are not considered to be financial instruments. The definitions of financial instruments under Annex 1.C.6 and C7 should also clearly reference the intention to settle the contract physically rather than the weaker "possibility" of financial settlement.
	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?	RWE has no comments on this question.
	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?	RWE has no comments on this question.
	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?	RWE has no comments on this question.

	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?	As we have noted above, many gas and power markets rely on less-standardised platforms and products out of necessity rather than choice. In many markets, the choice of how to execute and settle trades underpins the very existence of market and the presence of any liquidity and transparency over market prices. Far from improving transparency and stability, attempts to move this activity onto regulated, cleared platforms may have the opposite effect and drive trade back to bilaterally-negotiated, non-standard and opaque transactions. In the limit, participants will seek to avoid wholesale markets completely and reintegrate along the value chain to the detriment of competition and the Single European Energy Market. It is for this reasons that the boundaries of MIFID, in terms of the participants, products and platforms for trading energy and other commodities needs to be approached with caution and with detailed analysis of the impacts. MIFID should require regulators both to undertake detailed analysis and to consult with market users prior to the "designation" of any derivative as required to be traded on a regulated platform. Not only is the Title V requirement of concern in respect of market liquidity and participation, the incremental benefits of trying to force the execution of more trades onto organised venues is less than clear in energy markets. The combination of REMIT and EMIR will provide adequate transparency on market volumes and prices and EMIR will require all standardised products to be cleared in any case. It also ignores the existing trend for trade to migrate to regulated instruments and platforms and for OTC volumes to be given up for clearing when it makes economic sense to do so as markets mature and liquidity grows..
	12) Will SME gain a better access to capital market through the introduction of an MTF SME growth market as foreseen in Article	RWE has no comments on this question.

	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?	Rules which seek to shift trading and settlement to particular venues inevitably restrict choice and competition between execution and clearing providers to some extent. In this context, non-discriminatory access is not just desirable, but essential and MIFID should include appropriate provisions to monitor and enforce the fulfilment of this principle.
	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?	Market platforms and regulators should not be given powers to set ex-ante position limits for commodity derivatives. RWE sympathises with public concerns over commodity price levels and volatility and the problems this can cause to both consumers and producers. However, in anything but the very short-term, commodity prices are inevitably driven by global supply and demand fundamentals rather than speculation on future price levels. Not only is a (speculative) seller required to fill every speculative purchase, but with limited storage, commodity markets must ultimately match the supply and demand of the underlying physical product over time. Moreover, there is no evidence that position limits would actually reduce volatility in any case. (If anything the evidence points to the opposite and that price movements are amplified at times of significant change as a consequence of participants being forced to close positions.) Hard ex ante limits on individual commodity assets are a blunt and inflexible tool which cannot practically capture the complex and diverse interactions involved in the underlying production, movement and delivery of physical commodities and the motivation of those holding the associated derivative positions. In many markets (eg,

		wheat, electricity) producers may sell well in advance of actual production, with consumers buying later in the cycle whereas in other markets (eg, gas and oil) consumers often want to buy in advance of producers selling. Moreover, commodity producers, consumers and intermediaries may often trade in different, but related, products and geographies to manage their risk exposures, eg, selling power forward in Germany to hedge a production position in the Netherlands (because Germany has a more liquid market), trading gas to manager a power position or buying electricity to manage exposure to aluminium prices. In this context, the "risk" posed by even very large derivative positions cannot be sensibly assessed – never mind constrained – without considering the underlying production, merchant, storage, consumption and risk management positions of individual participants. The dynamic and changing nature of the physical commodity markets and the complexity of these interactions make it impossible for regulators or market operators to set appropriate hard limits on individual commodities. The result – inevitably – will be that any limits will be inappropriate and will distort routine, commercial risk management activity as participants either fail to hedge real, commercial risks or are forced into inferior "dirty" hedges in interconnected markets where they are not similarly constrained. Even greater volatility will also result as market participants are forced to manage position limits in addition to their underlying risk positions. Greater transparency is the first line in tackling concerns about market volatility and speculation and regulators should refrain from intervention until a problem has been clearly understood and articulated. Without data on trade patterns, positions and price formation regulators cannot make <u>any</u> considered assessment of the purported problem and the likely impact of position limits and against the certainty of market distortion, We therefore welcome the provisions of EMIR and REMIT to provide regulators with greater sight of – and hopefully therefore confidence in the integrity of - the commodity markets and price formation. Pending a considered assessment of the problem, RWE would recommend a system of

		position management and reporting operated by the regulated platforms themselves. The platforms have the detailed expertise and knowledge of the markets they oversee and are the best placed to enter into an informed dialogue with market participants and to secure the reduction of any positions of concern. MIFID should also include clear provisions to exempt risk management activities from position management to limit the distortion to the underlying commodity markets from ill-fitting constraints. This can be done by defining that commercial firms shall not be subject to position limits for those products that are used for risk management activities. Not only should regulators and regulated platforms not have powers to impose hard ex ante limits on derivative positions, they most certainly should not have any powers in relation to the underlying physical commodities. This would represent a wholly unwarranted and unprecedented intervention by financial regulators into the very heart of international trade and commerce. The MIFID text should make it absolutely clear that any power to impose position limits should not apply to the physical markets in the commodities themselves.
Investor protection	15) Are the new requirements in Directive Article 24 on 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?	Changes to the MIFID exemptions and to the definition of regulated products and platforms expose corporate end-users to the following requirements under other legislation: (a) capital adequacy requirements under CRD (once the current CRD exemption expires in the end of 2014)

		(b) central clearing requirements under EMIR (OTC Derivatives Regulation); (c) market conduct rules under the Market Abuse Directive (MAD). It would not be appropriate to apply capital and clearing requirements designed for financial firms to non-financial corporates and there is a clear need to consider the MIFID exemptions in tandem with the review of the CRD legislation. The CRD exemption for commodity traders (and/or the corresponding MIFID exemption) should also be extended until such point as the capital rules in respect of commodity traders have been properly assessed and decided. It would be anomalous if non-financials fell under EMIR's threshold for exemption from the requirement to clear standardised derivatives, but then found themselves designated as financial companies under MIFID and hence required to clear "by the back door". This would suggest that MIFID should also incorporate a similar threshold for exemption whether directly or indirectly by reference to the EMIR threshold. Regulators will need to take great care at the boundary of MAD/MAR and REMIT – as effectively defined by MIFID - to ensure that power and gas traders are treated equitably and consistently across the financial and physical market places and are not subject to double jeopardy and wider confusion.
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	The exclusion of physical energy and commodity markets in the US under the Dodd-Frank Act needs to be accounted for via parallel exclusions in the EU if trade is not to be distorted in favour of US markets and companies.
	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?	