

Review of the Markets in Financial Instruments Directive

Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

VATTENFALL RESPONSE

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?	Vattenfall is of the opinion that energy companies whose main business is the production or supply of energy and who trade on energy markets on own account in order to manage commercial risk, should remain exempted from MiFID ¹ . There are several reasons for keeping utilities like Vattenfall out of MiFID for the majority of their trading activities:

¹ Several energy companies including Vattenfall already have acquired a MiFID license for a specific part of their business. These MiFID licensed entities offer investment services (in energy related products) to customers. In order to offer the consumers of these products sufficient protection, these separate legal entities are – and should stay - subject to the same MiFID rules that are also applicable to financial institutions. The new MiFID proposals could however require that not only these activities will be MiFID regulated, but that *all* trading activities, including those on a company's own account would become subject to the MiFID rules.

		<ol style="list-style-type: none"> 1) There is no theoretical or empirical evidence that energy companies give rise to systemic risk in the economy². If an energy company would go bankrupt, the physical supply will remain in tact. Energy companies have a totally different risk profile than financial institutions. 2) Applying MiFID overlaps with existing and upcoming regulation for energy companies, mainly REMIT, EMIR and rules from the Third Package. The requirements from REMIT and the Third Package will adequately improve trust as well as transparency of wholesale energy markets, whilst taking into account the specifics of these markets. EMIR sufficiently addresses systemic relevance of non-financial players by setting clearing thresholds. 3) The impacts of MiFID on energy companies will be disproportionate. Applying MiFID to energy companies will automatically lead to the obligation to centrally clear all derivative transactions under EMIR. Central clearing requires (initial and variation) margin to be posted for every traded contract. Hence, large amounts of cash would have to be posted on clearing platforms. These are
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² The consequences of the bankruptcies of Enron, LBCI and TXU for other energy firms as well as the financial system have been limited. Besides that, derivative trading on energy does rarely cause price swings that are not in line with market fundamentals. Source: SEO Economic Research; Curtailing Commodity Derivatives Markets, October 2011

³ A study from Amsterdam-based SEO economic research (see footnote above for reference) concludes that central clearing of all standardised gas and power derivative transactions generates higher social costs than benefits, leading to a negative impact on economic welfare in only the Netherlands of around € 2.4 – 3 billion. Based on these numbers, Bloomberg estimated that “companies from RWE AG to Vattenfall AB may have to find an extra 69 billion euros (\$93 billion) to meet unprecedented European Union regulations designed to crack down on speculation in the region’s energy markets”³. MiFID II may thus not only affect a utility’s ability to invest, but it will also negatively impact the society as a whole.

		<p>estimated to be almost 70 billion € for European energy companies³. This would mean that energy companies have less cash available to invest in e.g. (renewable) production capacity. This impact will be exacerbated once the proposed exemption in the Capital Requirements Directive (CRD) will expire in 2014 and energy companies need to hold even significant higher amounts of capital.</p> <p>In the MiFID II proposal, the specific exemption for commodity dealers is deleted. The European Commission is clear in its intention that energy companies should be able to make use of the ancillary activity exemption, but to our opinion this is not clear from the legal text.</p> <p>To overcome the current uncertainty, we have the following <u>recommendation</u>:</p> <p>Criteria should be added to MiFID II Article 2(1)(i) to clearly show that utilities with major assets trade as an ancillary activity. The proposed criterion that an ancillary activity should be objectively measurable as reducing risk may lead to the wrong interpretation that only pure hedges will be seen as ancillary activities, whilst risk management of energy companies also includes the optimisation of hedges and further asset optimisation. Both are nevertheless ancillary to the main business (which is energy supply and production).</p> <p>We therefore <u>recommend</u> that a criterion be added that relates to the risk exposure of trading compared to the risk exposure of</p>
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		<p>other activities of an energy company (production & supply).</p> <p>When the risks that stem from trading are substantially smaller than the risk from the production and supply of energy, the trading activity should be considered ancillary. For Vattenfall, the total Value at Risk of trading activities compared to the Value at Risk of the company is very modest (<<5%).</p>
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	<p>It is not appropriate to include EU emission allowances (EUAs) in MiFID, as it means that overly complicated reporting and capital requirements stemming from the revised MiFID and MAR would become applicable to EUAs, at least to those parties trading in EUAs who are not exempted from MiFID. This may force some companies to discontinue their trading activities in these products, possibly leading to a lower liquidity of the market.</p> <p>We have the following <u>recommendation</u>: In case specific market integrity measures have to be proposed, they should be developed in a tailor-made regime for emission trading. Such tailor-made regime should address the necessary specific market integrity measures, but exclude the unnecessary reporting and capital requirements introduced by MiFID, CRD and MAR.</p>
	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?	<p>The OTF category definition may theoretically make sense, but in practice could have significant impacts on liquidity of the energy wholesale market.</p> <p>Vattenfall interprets the newly proposed category OTF as including broker trading platforms. Broker trading is currently an off-exchange way of trading, which is frequently used by energy companies to execute physical trades as an efficient way to reduce credit risk. With the new category OTF, broker trading will become subject to the mandatory platform trading rules as defined in MiFIR and EMIR. Some brokers may be forced to leave the market, thereby pushing energy companies towards more platform trading. The same effects as described in the reply to question 1 will materialise: energy companies (that do not give rise to systemic risk) would have to post disproportionately high amounts of cash for clearing, in the end leading to a less efficient energy wholesale market.</p> <p>This impact is related to the inclusion of all physically settled derivatives traded on OTFs in the definition of financial instruments in MiFID Annex I, Section C.6: traders in these</p>

		<p>physically-settled products will have to comply with burdensome and unnecessary rules, possibly leading to less trading activity in these products and thus in less liquidity on the wholesale market.</p> <p>Even if utilities would be exempted from MiFID, the classification of these derivatives as financial instruments would mean that for these transactions, energy companies would have to comply with the Market Abuse Regulation. This would conflict with targeted requirements on market abuse for the power and gas market in REMIT, and would not be in line with the US Dodd-Frank Act.</p> <p>Our strong <u>recommendation</u> is therefore to reconsider the introduction of the proposed category OTF and to explicitly exclude OTF transactions that will be physically settled (and are already covered by REMIT) from the classification of financial instruments in Annex I, Section C.6.</p>
	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?	<p>Energy companies currently primarily trade OTC. As energy companies do not pose systemic risk to the financial system, and as these OTC transactions are an essential part of energy companies' risk management, it is essential that energy companies can continue to trade OTC, hence that these transactions (including those on broker screens) stay out of the clearing regime. See the answer to question 1 for an indication of the impacts in case all energy commodity trades would be pushed towards regulated markets.</p>
	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	Although we see the need to set position limits in certain parts of the financial market, we believe that commodity prices are

	<p>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?</p>	<p>driven by market fundamentals rather than speculative behaviour. Position limits hinder effective risk management as companies would be allowed to manage their commodity price risks only up to a certain level. These limits hamper energy producers, for example, in forward selling their electricity production to a sufficient extent, or being able to buy the emissions certificates required to produce electricity. In addition, position limits can affect market liquidity and thus increase price volatility.</p> <p>We would support position management combined with appropriate position reporting rather than position limits: regulatory supervision of positions is a sufficient measure to ensure the proper functioning of markets. The requirement for position reporting in real time on commercial firms active as participants or members on regulated trading platforms is however not appropriate.</p> <p>We would therefore <u>recommend</u> a provision to exempt risk management activities. 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.</p> <p>On reporting of positions, we <u>recommend</u> that proportionate arrangements have to be introduced, i.e. that the operators of these platforms will report on behalf of these firms and that market participants would be required to report on a weekly basis only positions in contracts not concluded through platforms as the information should be the basis for the weekly reports done by platforms.</p>
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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	The energy wholesale market is a specific market, and it is crucial that the views of energy stakeholders are properly taken

	and implementing MiFID/MiFIR 2?	<p>into account in developing and implementing MiFID/MiFIR 2. This is a prerequisite for European Supervisory Authorities to function well. If not, there is a serious risk that the energy wholesale market is seriously negatively affected, hence counteracting the achievement of the internal energy market objectives.</p> <p>We <u>recommend</u> that ACER and national energy regulators should fulfil an important role in ensuring that the specificities of the energy market are included. ESMA should also include representatives of the energy sector in its stakeholder groups.</p>
	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?	<p>The key interaction with EMIR is widely recognised in MiFIR. However, there are also crucial links with a non-financial piece of EU legislation: REMIT. First, REMIT is already improving transparency and efficiency of energy wholesale markets, and therefore certain MiFID requirements will be unnecessary and burdensome duplications for energy companies if they will not be able to make use of the ancillary activity exemption. Secondly, the definition of physical forwards as financial instruments in Annex I, Section C.6 (see reply to question 6) creates overlap with REMIT, which is already regulating physical transactions for power and gas.</p>
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	<p>The interaction with the US Dodd-Frank Act. Note that the Dodd-Frank Act does not classify physical transactions as financial instruments, contrary to the current definition in Annex I, Section C.6 of MiFID (see also reply to question 6).</p>

	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?	-