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MiFID II Level 2 & energy trading: the urgent need to further refine the ancillary activity exemption framework and to specify the C.6 REMIT carve-out

Dear Mr. Vice-President,

In light of the upcoming Commission's Expert Group of the European Securities Committee meeting on 19 May, we, Europex – the association of European energy exchanges, would like to draw your attention to two decisive elements in the framework of the MiFID II / MiFIR Level 2 legislative process and their considerable impact on the commodity markets and the energy trading landscape. This concerns in particular the proposed framework for the ancillary activity exemption, the definition of commodity derivatives, the critical interaction between these two policies as well as their impact on trading behaviour and market structure.

Notably, Europex would like to highlight that the **ancillary activity framework** proposed by ESMA in its Consultation Paper of 19 December 2014 would require the majority of energy trading firms to become MiFID-licensed, thereby becoming subject to considerable capital requirements. This approach risks resulting in the withdrawal of numerous small- and medium-sized non-financial firms from wholesale energy trading. Market liquidity would furthermore be fragmented between financial firms trading in products under the scope of MiFID II, whilst non-financials aiming to avoid a MiFID license would to a large extend limit trading activity to products which do not count for the ancillary activity thresholds (i.e. products subject to REMIT only).

Therefore, in line with the Level 1 text of MiFID II and the provided Level 2 mandate, Europex, in cooperation with the main European and national associations dealing with energy trading (BDEW, Energy UK, Eurogas, EFET and Eurelectric), developed a joint proposal which refines the ancillary activity exemption framework. The proposal includes a risk weighted treatment of cleared contracts that are subject to the rules of regulated markets (RMs) as regards the calculation of the ancillary activity thresholds. This approach would ensure a more proportionate application of the exemption framework and would concurrently provide the right incentives for non-financial firms to trade in a more regulated and cleared trading environment. This would ultimately maintain the necessary market structure with centralised liquidity pools.

Moreover, we are deeply concerned by the proposed "proportionate arrangements" requirement in relation to the **financial instrument** definition in Annex I Section C Point 6 which **needs to be further detailed** in order to prevent potential loopholes and to ensure a harmonised application in all 28 Member States in accordance with Recital 10 of MiFID II. A wide carve-out of gas and electricity products could have the adverse effect that liquidity would shift from Regulated Markets towards a less regulated trading environment outside the scope of MiFID II and EMIR. This effect contradicts the G- 20 Pittsburgh commitments of promoting more transparent, non-discriminatory and systemically safer markets and the specific aims of the MiFID review aiming to prevent market abuse, systemic risk and to achieve a level playing field.

For your convenience, please find attached the Europex position paper on the ancillary activity exemption and the definition of mandatory physical settlement – which outlines our position in more detail. Further attached to this letter you find the above mentioned common paper on the ancillary activity exemption.

We look forward to your response and remain at your disposal for any questions you may have.

Yours sincerely,

Massimo Ricci
Chairman

europex
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MiFID II Level 2 & Energy Trading:
How to further specify the ancillary activity exemption and the definition of mandatory physical delivery?

Executive summary

Europex, the association of European energy exchanges, is very concerned about the potential impact of the currently proposed MIFID II level 2 arrangements. If adopted without changes, they will incentivise market participants to trade in a less regulated and less transparent trading environment or will lead to a full withdrawal from commodity trading altogether. In particular Europex is concerned about the potential combined impact of the proposed policies on ancillary activity and the carve-out of a considerable portion of gas and electricity derivative contracts from the scope of MiFID II and EMIR.

Europex worries that both pieces of legislation are not sufficiently aligned. For instance: the reasoning for a power & gas carve-out is flawed because the ancillary services definition includes physical hedging activities. Europex is convinced that a broad gas and power carve-out combined with a low ancillary activity threshold will drive liquidity away from regulated markets onto less regulated trading venues. A narrow carve-out combined with a narrow definition of ancillary activity will likewise seriously damage liquidity in European power and gas markets. This is why Europex argues for a better alignment of the two arrangements in order to ensure that all relevant policy goals will be balanced and competition between trading venues will not be unnecessarily distorted.

Europex considers that:

- The proposed relatively low ancillary activity thresholds will require many physical firms to become MiFID authorised, although it is highly questionable whether these firms are systemically relevant. Given the direct linkage of MiFID II to the applicability of CRD IV, a large majority of real economy physical companies, including e.g. small and medium-sized utilities, would have to become MiFID authorised investments firms and meet considerably higher capital requirements than today. In addition, they would become financial counterparties under EMIR.

- The energy industry has expressed wide-spread concerns about the complexity of ensuring compliance with the proposed Level 2 framework. In combination with the resulting uncertainty posed by the still to be defined calculation methodology for the thresholds, these have resulted in non-financial energy trading firms arguing for an extension of the carve-out of gas and electricity derivatives that must be physically settled and that are traded on an OTF.

- A wide carve-out of gas and electricity products could have the adverse effect that liquidity would shift from Regulated Markets towards a less regulated trading environment outside the scope of MiFID II and EMIR. This effect contradicts the G-20 Pittsburgh commitments of promoting more transparent, non-discriminatory and systemically safer markets and the specific aims of the MiFID review aiming to prevent market abuse, systemic risk and to achieve a level playing field. Europex had

therefore always argued against a platform specific carve-out of economically equivalent products.

- The withdrawal of non-financial firms would have a significantly negative impact on liquidity in European wholesale gas and electricity markets that are currently still under development. Many non-financial companies would not be able to cope with the cost increase and may either largely reduce their trading activity or shift activity to OTF platforms. Thus, wholesale gas and power markets would be fragmented and numerous EU policies, including EMIR and MiFID II/MiFIR, would be undermined.

- The aim of including non-financial commodity firms in the scope of MiFID II therefore needs to be balanced and put in relation with the other important policy goal of enabling liquid and transparent gas and electricity wholesale markets.

Europex suggests amending the Level 2 arrangements in order to recognise the direct interaction between the ancillary activity exemption and the REMIT carve-out by both:

A) **Recalibrating the ancillary activity thresholds** and **incentivising** non-financial firms to trade in exchange traded (under the scope of MiFID), cleared products (under the scope of EMIR). Counting commodity derivatives and emission allowances that are traded on Regulated Markets (RMs) towards the ancillary activity thresholds in a risk-adjusted manner would allow a more proportionate number of non-financial market participants to make use of the ancillary activity exemption. It would simultaneously incentivise a shift in trading activity towards the more regulated trading venues and reduce counterparty risk in European wholesale commodity markets.

B) Further **specifying the proposed "proportionate arrangements" requirement** in relation to the financial instrument definition in Annex I C6. In order to define a contract as being "must be physically settled", trading companies must have the obligation to put "proportionate arrangements" in place to deliver/take delivery of the underlying commodity. If this obligation is strictly applied, it will ensure that contracts that "must be physically settled" get effectively delivered. This will prevent regulatory arbitrage as stipulated in Recital 10 of MiFID II and will also ensure a minimisation of systemic risk - a key intention of MiFID II - since EMIR will remain applicable to the majority of power and gas contracts.

A. Recalibrating the ancillary activity thresholds and incentivising non-financials to manage their exposure through exchange-traded, cleared contracts

A.1 Introduction

The proposed relatively low ancillary activity thresholds will require many physical firms to become MiFID authorised, although it is highly questionable whether these firms are systemically relevant. Given the direct linkage of MiFID II to the applicability of CRD IV, a large majority of real economy physical companies, including e.g. small and medium-sized utilities, would have to become MiFID authorised investments firms and meet considerably

higher capital requirements than today. Many non-financial companies would not be able to cope with the cost increase and may either largely reduce their trading activity or shift activity to OTFs, hence trading in derivatives outside the scope of MiFID II/MiFIR and EMIR.

Exchanges pool liquidity through providing non-discriminatory access to a central trading environment and an order book, which is subject to mandatory pre- and post-trade transparency. A withdrawal of non-financials from trading on regulated markets risks triggering a vicious circle of a liquidity decline, a further fragmentation of energy markets and the undermining of the MiFID II/MiFIR and EMIR frameworks. Lower wholesale market liquidity would furthermore result in significantly higher trading costs. The aim of including non-financial commodity firms in the scope of MiFID II therefore needs to be balanced and put in relation with the other important policy goal of enabling liquid and transparent gas and electricity wholesale markets.

Moreover, a narrowly defined ancillary activity exemption incentivises non-financial firms to shift trading activity towards non-MiFID regulated markets - i.e. puts pressure on them to make extensive use of the C6 carve out.

A.2 Recalibrating the ancillary activity thresholds

Europex deems appropriate that both tests must be failed in order for an entity to be required to obtain a MiFID license. We understand that this is in line with the Level 1 text and the mandate given to ESMA by the Commission. The mandate explicitly asks ESMA to develop a methodology where both the ancillary nature and the trading size of the activity are taken into account in order to determine whether a firm should be captured by the scope of MiFID II or not.

A.2.1 First test - "Capital employed"

Europex considers the proposed threshold of 5% as inappropriate for the first test, especially when it comes to gas and power markets. Cautious thresholds should be set at first to avoid forcing small entities to exit the market and generally causing an irreversible drop in liquidity. These thresholds could eventually be lowered at a later point in time based on an in-depth economic analysis and lessons learnt from the application of MiFID II. The recalibration of the thresholds could coincide with the required report in 2018 that will provide an assessment of "the potential impact on energy prices and the functioning of the energy market of the expiry of the transitional period provided for the application of the clearing obligation and the margining requirements set out in Regulation (EU) No 648/2012".

A.2.2 Second test - "Market share"

As far as gas and power trading is concerned, Europex considers the threshold to be significantly too low. In the context of their complex historical development, the market structure in these markets is less multipartite compared to others. Utility companies that used to be politically desired regulated monopolies before the liberalisation and other firms who have a naturally large physical position in these markets, would be unable to benefit from the ancillary activity exemption as they would inevitably breach the 0.5% threshold.

For gas and power trading, it is of great importance that the size of the overall trading activity in the relevant asset class takes into account all trading activity and not only the trading activity in financial instruments. If REMIT non-financial instruments, e.g. C6 exempted contracts, were not taken into account for determining the size of the overall trading activity, it is likely that even small companies could be caught by the 0.5% threshold. It is therefore insufficient to calculate the overall market trading activity via EMIR TR data only, because this data does not include contracts that must be physically settled and that are traded on OTFs.

As with the first test, cautious thresholds should be set at first to avoid forcing small entities to exit the market and generally causing an irreversible drop in liquidity.

A.3 Incentivising non-financials to trade exchange traded, cleared contracts

The risk reducing effect of central clearing by Central Counterparties (CCPs) should be reflected in the determination of the ancillary activity tests. Europex suggests that commodity and emission allowances derivatives that are traded on Regulated Markets (RMs) should only count towards the ancillary activity thresholds in a risk-adjusted manner. This aspect is taken into account by the European Market Infrastructure Regulation (EMIR). Under EMIR, exchange-traded and centrally cleared derivatives (ETDs) do not count towards the clearing threshold. The significant narrowing of the MiFID I exemptions in MiFID II are primarily aimed at mitigating systemic risk. Yet, contracts traded on regulated markets are by definition centrally cleared and thus do not pose the same level of systemic risk as non-cleared contracts that are traded on other, less regulated platforms. The future Level 2 regulatory technical standard on ancillary activity should also take into account that Regulated Markets already impose high requirements on their members (irrespective if they are financial or non-financial firms), namely:

- Mandatory clearing imposed on every traded contract;
- Full pre- and post-trade transparency;
- Control of algorithmic trading;
- Capital requirements for clearing purposes;
- Organisational requirements for trading companies;
- Strict Know Your Customer (KYC) procedures and membership requirement, as well;
- Active supervision of all trading activity.

When a derivative is centrally cleared, the counterparty default risk is managed through the CCP. The risk to cover an open position of a trading participant in the event of a default corresponds to the initial margin. The actual value of the initial margin can vary depending on the contract as it depends on the given market volatility. In gas and power derivative markets, initial margins do not exceed 15%.

Europex therefore suggests to either fully exempt cleared volumes for the calculation of the ancillary activity thresholds or that the capital employed for carrying out the ancillary activity should be measured via the initial margin in relation to contracts traded on a RM. Thereby, an exchange-traded contract would be considered with 15% compared to an OTC-derivative with similar characteristics which is not cleared. This would better reflect both the actual capital employed by the market participants as well as the risk structure of cleared contracts.

Weighing the RM traded contracts with a risk-adjusted method would result in taking into account 15% of the costs of each contract traded on Regulated Markets in the calculation of the ancillary activity tests. These requirements are comparable to those imposed on MiFID II licensed entities. Exactly as MiFID II licensed activities are excluded from the ancillary activity calculation, transactions concluded on RMs could be weighed proportionately. This would:

(a) incentivise non-financial firms to trade in exchange traded (under the scope of MiFID II), cleared products (under the scope of EMIR). The proposal would therefore incentivise a shift in trading activity towards regulated trading venues and would thereby reduce counterparty default risk and systemic risk in European wholesale commodity markets.

(b) be in line with the G-20 Pittsburgh commitments of promoting more transparent, non-discriminatory and systemically safer markets and the specific aims of the MiFID review of preventing market abuse, systemic risk and achieving a level playing field.

B. Specifying the proportionate arrangements requirement

B.1 Introduction

A clear definition of financial instruments in relation to commodity derivatives in MiFID II, capturing the majority of gas and power contracts, will ensure that MiFID II and EMIR will be widely applicable to gas and power trading and will thus help mitigate systemic risk in these markets. This will ensure that specific requirements such as the position limit regime, position reporting and algorithmic trading restrictions remain effective and implementable.

The definition of financial instruments in MiFID II Annex I Section C Point 6 with regard to derivative contracts in wholesale energy products "that must be physically settled" is crucial for fair and effective energy markets in Europe. In this context and based on Recital 10 of MiFID II, ESMA has recently provided the following technical advice to the European Commission: *"For the purposes of further specifying wholesale energy contracts under Section C 6 and C 6 energy derivatives contract, a contract "must be physically" settled if "it contains provisions which ensure that parties to the contract have proportionate arrangements in place to be able to make or take delivery of the underlying commodity."*

This is indeed a step in the right direction. However, the important task remains to further specify the actual meaning and practical implementation of the above mentioned "proportionate arrangements".

B.2 The need for further specifying the ESMA Technical Advice

One element of the ESMA Technical Advice regarding the definition of commodity derivatives that "must be physically settled", constitutes the requirement to have in place "proportionate arrangements" to take or make delivery of the underlying commodity. As the remaining other requirements for classifying contracts as "must be physically settled" will generally be met by most utilities active in commodity derivatives markets, the proportionate

arrangements requirement will in practice have a considerable impact on the scope of MiFID II and to what extend commodity derivatives are included.

The general wording of the “proportionate arrangements” requirement currently lacks a clear legal framework and guidance for assessing whether parties trading energy contracts that classify as “must be physically settled” are actually adhering to the requirement. The wording is therefore likely to be interpreted differently by National Competent Authorities (NCAs) and would result in legal uncertainty and a non-harmonised application of MiFID II in Europe. Moreover, trading venues such as OTFs should not be made responsible for determining the “proportionate arrangements” as this would result in a similar negative situation.

MiFID II, specifically Recital 10, requires the implementation of a clear legal framework in order to prevent a possible loophole. The currently proposed proportionate arrangements requirement does not sufficiently prevent parties from interpreting the requirement in such a manner that they could potentially trade a disproportionate volume in “must be physically settled” contracts. For instance, holding a balancing contract with a Transmission System Operator (TSO) should not be considered as a sufficient arrangement as it does not indicate whether the actual trading is backed by physical assets.

B.3 Considerations for specifying “proportionate arrangements”

In order to define “proportionate arrangements” in line with the Level 1 text of MiFID II, one should take into account the relationship between:

> (1) the total volume of wholesale energy contracts that are traded by individual trading entities on OTFs and that are not considered financial instruments (i.e. contracts “that must be physically settled”) and that are entered into by one party for a specific delivery period, and;
>
> (2) the gross volume of the party’s arrangements to make or take delivery of the underlying commodity during the same period.

It is hereby essential to further specify the above mentioned two elements in order to ensure that the ‘proportionality requirement’ can be adhered to by market participants.

Concerning 1. (‘Total volume of wholesale energy contracts classified as “must be physically settled”’)

The calculation should:

- Correspond to the total volume of wholesale energy contracts “that must be physically settled” with a delivery date in the corresponding year. (For delivery periods exceeding the limits of the calendar year, only the part of the volume in the respective year should be taken into account.)
- Be conducted periodically, e.g. on a yearly basis, by each individual market participant who is a party to a contract classified as “must be physically settled”.
- Be done separately for gas, power, coal and oil. The use of capacity in one energy product for trading in non-financial instruments in another energy product would not

be in line with the MiFID II Level 1 agreement, in particular Recital 10. Once the ‘proportionality requirement’ is to be assessed for the volume which an individual market participant is trading, it should not be allowed that, e.g., the gas capacity of a participant is used to trade related volumes in exempted electricity products. It should then only be allowed to trade in non-financial exempted gas products.

Concerning 2. (‘Volume of the party’s arrangements to make or take delivery’)

- These arrangements should apply to the generation, production, storage and consumption.
- These arrangements should apply to the generation, production, storage and consumption.
- These terms are defined in the Directive 72 and 73/2009/EU
- More information for power can be found on the ENTSO-E transparency website (https://www.entsoe.eu/Documents/MC%20documents/Transparency%20Platform/150101_Transparency%20Platform%20Data%20Categories.pdf).

Conclusion

In the case of gas and power derivatives, the goals of MiFID II/MiFIR, namely 1) to prevent market abuse and 2) to minimise systemic risk, are well addressed by REMIT and EMIR respectively, provided that the C6 exemption is specified in a balanced way and that it only covers the limited share of physically settled derivatives. In addition, such a balanced definition would ensure a level playing field between trading venues and between member states as explicitly stipulated in MiFID II Level 1.

A narrow definition of the ancillary activity exemption, and thus a broad classification of firms trading in gas and power derivatives as investment firms, would substantially increase the regulatory burden and cost of trading and would significantly harm partly immature markets. Furthermore, a narrow definition of the ancillary activity exemption increases incentives to avoid both MiFID II/MiFIR and EMIR via the C6 exemption, which in turn would increase systemic risk. This would fundamentally undermine the achievements of the past 15 years in the development of truly integrated European wholesale gas and electricity markets as well as the goals of EMIR and MiFID II/MiFIR themselves.

MiFID II Level 2 and energy trading:

How to further specify the ancillary activity exemption in Article 2?

17 April 2015

1. Introduction

The undersigned associations believe that open, robust, liquid, competitive and transparent energy markets are key to ensuring secure, sustainable and competitive energy supplies for final customers, together with adequate infrastructure and a supportive regulatory framework. With this core and shared objective in mind, and while fully supporting the overall principles of the revised Markets in Financial Instruments Directive 2014/65/EU (MiFID II), we are nevertheless very concerned by some of the provisions which are currently being discussed in Level 2.

The low ancillary activity thresholds proposed in the Regulatory Technical Standards (RTS), which ESMA is due to send to the European Commission by the 3rd July 2015 for adoption, would require many energy trading firms to become MiFID-authorised, despite the fact that these firms are not comparable to purely financial entities. Energy trading firms pose no threats to deposits, raise no issue of investor protection and have no access to central bank liquidity.

Given the direct linkage of MiFID II to the applicability of CRD IV[1], a large majority of real economy physical companies, including small and medium-sized utilities, would have to meet considerably higher capital requirements than today (e.g. in relation to the tier-one capital, liquidity and large exposure regimes of CRR/CRD IV). The same applies to the mandatory clearing obligation under EMIR[2]. Once those firms are required to obtain a MiFID-license, they will not be able to qualify anymore for the specific provisions for non-financial counterparties (NFCs). As a result, many non-financial companies would not be able to cope

[1] Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms
[2] Regulation 2012/648/EU on OTC derivatives, central counterparties and trade repositories

with the cost increase and may either largely reduce their trading activity or move it to non-financial markets and/or venues outside the European Union.

Exchanges pool liquidity through providing non-discriminatory access to a central trading environment and an order book, which is subject to mandatory pre- and post-trade transparency. A withdrawal of non-financials from trading risks triggering a vicious circle of declining liquidity and a further fragmentation of the energy markets, which could undermine the MiFID II/MiFIR and EMIR frameworks alike. Lower wholesale market liquidity would result in significantly higher trading costs. It would undermine competition and increase market entry barriers as potential entrants would be deterred by the high costs and/or the inability to hedge. This would, in turn, have a direct effect on energy prices and ultimately, on final energy consumers. The overall impact on the EU economy would be a significant increase in energy prices at the expense of competitiveness and economic growth.

Rising energy prices are also in stark contrast to the outlined policy of the European Commission for an EU Energy Union which is based on the following five pillars: (i) energy security, solidarity and trust; (ii) a fully-integrated European internal energy market; (iii) energy efficiency contributing to the moderation of demand; (iv) decarbonising the economy; and (v) research, innovation and competitiveness. In its recent communication, the European Commission estimates that "*the transition towards a more secure and sustainable energy system will require major investments in generation, networks and energy efficiency, estimated at some € 200 billion annually in the next decade*"[3].

In this context, the Agency for the Cooperation of Energy Regulators (ACER) considers a churn rate of at least 8 as necessary to obtain a sufficiently liquid market. ACER thereby recognises that energy traded more than once is not an expression of "speculative trading", but simply a way for the energy sector to optimise and hedge their (physical) positions.

Most recently, in its response[4] to the latest ESMA MiFID II/MiFIR Level 2 consultation, the Council of European Energy Regulators (CEER) expresses concerns that there is a "need to recognise that energy markets are different and that financial regulation should not undermine the years of work building the Internal Energy Market (IEM) - which is a high-level political goal of the European Union." In addition, CEER points out that "[d]espite the approach suggested by ESMA in the Discussion Paper of May 2014, in particular with respect to the threshold level set for the ancillary activity test (at 50% of the group's main business), [CEER is] afraid that extremely low thresholds, as suggested for both the ancillary activity test and the trading activity test, would deprive the exemption of application more than envisaged by the legislator; whose intention is mainly to capture non-financial firms dealing in financial instruments in a disproportionate manner (see also Recital 20 of MiFID II). […] Therefore [CEER] suggest[s] that the setting of thresholds should take into account the features of commodity asset classes, for example by linking their levels to the systemic threat of non-financial firms' trading activities".

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[3] Energy Union Package – A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy – 25 February 2015 – http://ec.europa.eu/priorities/energy-union/docs/energyunion_en.pdf
[4] http://www.esma.europa.eu/system/files/esma_mifid2_cp_ceer_replyform.docx

2. Recalibrating the ancillary activity thresholds

We deem it important to clearly specify in the RTS that both tests must be failed in order for an entity to be required to obtain a MiFID license. We understand that this is in line with the Level 1 text and the mandate given to ESMA by the European Commission. The mandate explicitly asks ESMA to develop a methodology where both the ancillary nature and the trading size of the activity are taken into account in order to determine whether a firm should be captured by the scope of MiFID II or not.

2.1 First test - "Capital employed"

We consider the proposed threshold of 5% as inappropriate, especially when it comes to gas, power and emission allowances markets. A cautious threshold of at least 25% should be set initially to avoid forcing small entities to exit the market, thereby preventing an immediate, irreversible drop in liquidity. This threshold could be reviewed at a later stage, based on an in-depth economic analysis and lessons learnt from the application of MiFID II. The recalibration of the threshold(s) could e.g. coincide with the report required by Recital 160 of MiFID II in 2018 that will provide an assessment of "the potential impact on energy prices and the functioning of the energy market of the expiry of the transitional period provided for the application of the clearing obligation and the margining requirements set out in Regulation (EU) No 648/2012".

2.2 Second test - "Market share"

As far as commodity markets are concerned (gas, power and emission allowances in particular), we consider the threshold to be too low and very difficult to assess, due to the unavailability of data. ESMA's latest proposals would see the vast majority of energy trading and other real economy firms being regulated as if they were banks, subject to detailed oversight by financial regulators and forced to comply with onerous and costly rules on licensing requirements, capital and liquidity adequacy, etc. These obligations would trigger a cascade of materially adverse and unintended consequences for energy markets, energy consumers and the real economy. This damage to wholesale energy markets would also directly undermine the policy objectives of the 3rd Energy Package and the Single Energy Market. Illiquid wholesale markets reduce competition and market efficiency with direct effects on the production and retail markets. Energy prices for consumers and industry would increase as a result.

In line with the first test, a cautious threshold of at least 15% should be set initially to avoid forcing a large number of firms to exit the market and more generally to prevent an irreversible drop in liquidity. Against this backdrop, we call upon ESMA to take immediate steps to make publically available the 2014 market size data for each commodity asset class. Persons seeking to use the exemption should be enabled to make the required calculation through the data provided in order to anticipate potential effects of MiFID II on their businesses and to make arrangements as they deem necessary.

2.3 Applying a weight-adjusted approach to volumes on regulated markets

The risk-reducing effect of central clearing by central counterparties (CCPs) should be reflected in the determination of the two ancillary activity tests for capital employed and market share**.** Contracts traded on regulated markets are by definition centrally cleared and thus, have a different risk profile compared to non-cleared contracts traded outside regulated

markets. This is also reflected in EMIR where exchange-traded and centrally cleared derivatives (ETDs) do not count towards the clearing threshold. We suggest that the capital employed for carrying out the ancillary activity at the group level should be measured according to the initial margin for RM-traded contracts. The same should be applied to the calculation of the market size. Indeed, the risk to cover an open position of a trading participant in the event of a default corresponds to the initial margin. In energy commodities, this initial margin does not exceed 15%. Thereby, an exchange-traded contract would be weighted with 15% compared to an uncleared derivative with similar characteristics. This would not only better reflect the actual capital employed by the market participants but also the risk structure of the cleared contracts.

The RTS should also take into account that regulated markets already impose high standards on their members, irrespective of whether they are financial or non-financial firms. This includes mandatory clearing for every traded contract, full pre- and post-trade transparency, the control of algorithmic trading and capital requirements for clearing purposes. Additionally, there are organisational requirements for trading companies, strict "Know Your Customer" (KYC) procedures and membership requirements, as well as an active surveillance of all trading activity on the exchanges.

Applying these weight-adjusted methods would incentivise non-financial firms to trade in cleared products (under the scope of EMIR) on exchanges (under the scope of MiFID II). Counterparty risk and systemic risk in European wholesale commodity markets would thereby be reduced. Such an approach would also be fully in line with the G-20 Pittsburgh commitment to promote more transparent, non-discriminatory and systemically safer markets.

2.4 Emission allowances

Finally, MiFID II seems to underestimate the fact that energy groups normally manage their commercial commodity risks centrally, including the compliance obligations of the EU ETS. Whereas Art. 2(1)(e) of MiFID II exclusively exempts operators of installations that need to comply with the EU ETS, group entities buying emission allowances on behalf of the group remain in the scope of financial regulation.

Therefore, there is a danger that such central risk management entities can only make use of the ancillary activity exemption of Art. 2(1)(j) of MiFID II and that emission allowances traded for compliance reasons would fully count towards the thresholds of the ancillary activity exemption as proposed by ESMA. We strongly disagree with this approach and suggest that the RTS clearly specify that emission allowances can be considered as hedging / "risk reducing" transactions. Consequently, it should be allowed to exclude them from the calculation of the ancillary activity thresholds, independently of whether they are entered into by the operator of the EU ETS compliance installation or by a central risk management entity within the same group. Otherwise central risk management group entities would find themselves caught in an EU ETS compliance trap, i.e. exposed to MiFID II licensing, because they will be very likely to breach the very low threshold proposed by ESMA.

This issue is crucial for the functioning of the EU ETS. The European Union has put a considerable amount of effort into repairing the European emissions trading market, which remains the primary instrument for achieving the decarbonisation of the European economy

and for fighting climate change. Damages to the liquidity of the emissions market would be contrary to a wide range of EU climate and energy policy goals.

BDEW
The German Association of Energy and Water Industries (Bundesverband der Energie- und Wasserwirtschaft - BDEW), Berlin, represents the interests of approximately 1,800 companies. The spectrum of its members ranges from local and municipal to regional and international companies. They represent about 90 percent of electricity sales, more than 60 percent of local and district heat supply, 90 percent of natural gas sales as well as 80 percent of drinking water abstraction and about one third of wastewater disposal in Germany.

EFET
The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent, sustainable and liquid wholesale markets, unhindered by national borders or other undue obstacles. We currently represent more than 100 energy trading companies, active in over 28 European countries. For more information, visit our website at www.efet.org.

ENERGY UK
Energy UK is the trade association for the British energy industry. We represent over 80 members made up of generators and gas and electricity suppliers of all kinds and sizes as well as other businesses operating in the energy industry. Together our members generate more than 90 per cent of the UK's total electricity output, supplying more than 26 million homes and investing in 2013 more than £13 billion in the British economy.

EURELECTRIC
The Union of the Electricity Industry - EURELECTRIC is the sector association which represents the common interests of the electricity industry at pan-European level, plus its affiliates and associates on several other continents. We currently have over 30 full members which represent the electricity industry in 32 European countries.

EUROGAS
Eurogas is an association representing 43 companies and associations engaged in the wholesale, retail and distribution of gas in Europe. Eurogas provides data and information relevant to EU decision makers and opinion formers in making the right policy choice.

EUROPEX
EUROPEX is a not-for-profit Association of European Energy Exchanges, currently with 21 members, representing the interests of exchange-based wholesale electricity, gas and environmental markets with regards to developments of the European Regulatory Framework for wholesale energy trading, while providing a discussion platform at European level.