

Company: *EuroPEX - Association of European Power Exchanges*  
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**EuroPEX Response to the**  
*“Public Consultation by the European Commission*  
*on the Review of the Markets in Financial*  
*Instruments Directive (MiFID)”*

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## I. Introduction

EuroPEX welcomes the opportunity to take part in the public consultation on the review of the Markets in Financial Instruments Directive (MiFID) launched on 8 December 2010. The initiative, tabled by the Directorate General for Internal Market and Services of the European Commission, includes numerous proposals aiming at a reform of the MiFID application to commodity derivative transactions.

The Commission's ideas would come with important implications for both energy exchanges (as organised trading facilities) as well as energy trading in derivative products itself. Therefore, we are looking forward to contribute to the further process and remain open to any questions and discussions.

The first part of the remainder states general remarks covering three broader issues that are addressed in different parts of the Commission's consultation document. It is indicated (in brackets) to which individual section of the consultation paper they relate. The second part includes specific responses to questions raised in the consultation paper.

## II. General Remarks

### A. Enhanced competition between trading venues

Greater competition across Europe in the provision of services between trading venues ranks among the key objectives of MiFID. Sharing full support with this aim, EuroPEX welcomes the Commission's proposal to improve the regulatory coverage of different types of trading venues – be it a regulated market, a MTF or another form of organised trading facility. These efforts can help to develop a level playing field for trading venues which, in turn, is a necessary prerequisite for true competition and for eliminating regulatory arbitrage.

1. We fully support the Commission's suggestion to apply a broader definition in MiFID to better regulate all organised trading which is currently outside the scope of the directive (2.2). This is especially relevant for commodity derivatives. However, unlike the original MiFID venues, these organised trading facilities shall be only made subject to "core requirements" (2.2.1). From our point of view, this could result in different degrees of robustness of the MiFID provisions, contradicting a harmonized regulatory approach between trading venues and potentially watering down MiFID requirements. Generally speaking, MiFID provisions should apply equally irrespective of what type of organised trading facility is concerned.

2. We welcome the significant extensions of MiFID to OTC markets as to the organisation, transparency and oversight which are foreseen throughout the Commission's consultation document. This will contribute to an equal treatment of trades regardless of whether they are executed on an organised trading venue or over-the-counter.

## **B. Transparency and oversight in commodity markets**

Transparency and oversight in commodity derivative markets features prominently in the Commission's proposals. Both elements are essential for a well-functioning market mechanism.

1. EuroPEX strongly supports clear and harmonised rules for market transparency as well as a robust oversight regime. However, undue costs and efforts in connection with excessive reporting obligations should be avoided. Apart from that, the MiFID review must not lead to a double-regulation with other initiatives pertaining energy markets. The MiFID review should be instead closely aligned with, for instance, the Commission's legislative proposal on energy market integrity and transparency (REMIT).
2. Applying transparency requirements to non-equity markets, if derivatives pursuant to the proposed OTC regulation (EMIR) are concerned, seems to be a reasonable alignment with EMIR (3.4). Given the particularities of the energy market, this calls though for a carefully calibrated approach. As regards pre-trade transparency, for instance, MiFID requirements must not allow for detrimental effects, namely abusive market conduct in energy markets (3.4.1.). Moreover, in order to avoid counterproductive over-regulation there should be a very strict and thorough monitoring of ESMA's assessment of what "eligible contracts" in the sense of EMIR are. To bring in a specific energy market perspective, the energy regulator's view (ACER) should be included into this process.

## **C. Exemptions for non-financial market participants**

With regard to the current scope of MiFID, the directive provides for two exemptions that are particularly relevant for firms dealing with energy derivatives. These exemptions are designed to provide hedging tools for the firms' actual main business (other than investment services) and concern both producers of commodities as well as commercial users. According to the Commission's proposals, the scope of exempted activities shall be significantly narrowed down in the MiFID review (5.2).

Generally speaking, EuroPEX favours a reasonable and cost-efficient approach. Therefore, from an energy exchange's point of view, exemptions for companies dealing in physical energy products (asset-backed companies), including their market-maker activities, must remain in place and should not be treated in a too rigid way. Otherwise, this could bring even smaller market participants within the sphere of financial regulation, thus imposing a disproportionate burden on these firms, which could potentially drive them out of the markets. As MiFID rules would come with the need to hold regulated reserves of capital and were attached to a multitude of operational and organisational requirements, cost of business would significantly increase for wholesale market participants. In some cases, these requirements, as they stand for the moment, might quite simply be impossible to respect for some smaller firms.

If the exemption regime is amended, this latest point should at least be taken into account and requirement calibrated to the type of firm concerned. By erecting such new barriers for entry into the market, this could potentially jeopardise the liquidity and depth of wholesale energy markets across Europe. In addition to that, the engagement of market makers is essential for developing markets for a new product, as they ensure tradability at any time, while liquidity is still in its infancy. Therefore, any burden for market makers should be avoided.

### III. Specific Aspects of the MiFID Review

#### 2.2.1 General requirements for all organised trading facilities

Q 2 *What is your opinion on the introduction of, and suggested requirements for, a broad category of organised trading facility to apply to all organised trading functionalities outside the current range of trading venues recognised by MiFID? Please explain the reasons for your views.*

We fully support the Commission's suggestion to apply a broader definition in MiFID to better regulate all organised trading occurring outside the current range of the directive. This is especially relevant for commodity derivatives. Unlike the original MiFID venues though, these organised trading facilities shall only be made subject to "core requirements". This could result in different degrees of robustness of the MiFID provisions, contradicting a harmonized regulatory approach between trading venues and potentially watering down MiFID requirements. In the context of the discussion to introduce general requirements for trading facilities the MiFID review should also be closely aligned with the Commission's legislative proposal on energy market integrity and transparency (REMIT). The reason is that commodity derivatives markets are always influenced by the underlying commodity spot markets.

### 2.3. Automated trading

Q16 *What is your opinion of the suggestion for risk controls (such as circuit breakers) to be put in place by trading venues?*

If obligatory risk controls are installed, the financial and organisational burden has to be assessed. The potential gain of such controls has to be proportional to the potential costs. It is the trader's decision and responsibility to adequately understand and manage automated trading devices. Apart from setting standards for market access and limitations, the trading venues should not be financially responsible for any further risk mitigation procedures.

### 2.5. Further alignment and reinforcement of organisational and market surveillance requirements for MTFs and regulated markets as well as organised trading facilities

Q23 *What is your opinion of the suggestions to further align organizational requirements for regulated markets and MTFs? Please explain the reasons for your views.*

We strongly support the alignment of organizational requirements for different types of multilateral trading venues. This can help to develop a level playing field for trading venues which is a necessary prerequisite for competition and for eliminating regulatory arbitrage. Therefore, rules should apply to all forms of organized trading facilities equally.

### 3.4. Non-equity markets

Q37 *What is your opinion on the suggested modification to the MiFID framework directive in terms of scope of instruments and content of overarching transparency requirements? Please explain the reasons for your views.*

Applying transparency requirements to non-equity markets – if derivatives eligible to central clearing pursuant to EMIR are concerned – seems to be a reasonable measure to align MiFID with EMIR. It has to be made sure though, that by obliging non-equity markets to fulfil the same transparency requirements as equity markets detrimental effects are avoided. These effects could result from the sheer costs and efforts in connection with excessive reporting obligations as well as from negative effects on pricing if transparency leads to market imbalance. In order to avoid counterproductive over-regulation there should be a very strict and thorough monitoring of ESMA's assessment of what "eligible contracts" in the sense of EMIR are.

#### **4.1. Improving the quality of raw data and ensuring it is provided in a consistent format**

*Q 43 What is your opinion of the suggestions regarding reporting to be through approved publication arrangements (APAs)? Please explain the reasons for your view.*

It is crucial for effectively applying additional reporting obligations to ensure that all trading venues are subject to the same obligations. For the benefit of market participants it is necessary to make the enhanced data volume available with the same minimum content throughout the whole European Union.

Regarding a consistent data format in energy derivatives markets – both exchange traded and OTC – regional product-specific peculiarities have to be taken into consideration. These usually refer to a specific location for physical fulfilment or a local bounded underlying.

#### **4.2. Reducing the cost of post-trade data for investors**

*Q 47 What is your opinion of the suggestions for reducing the cost of trade data? Please explain the reasons for your views.*

We cannot follow Commission service's evaluation that prices for trade data/information products are in general too high. There might be single cases where data providers charge unreasonable high prices. However, this is not a general observation and does not justify a price regulation of the competitive market data sector as such.

#### **4.3. A European Consolidated tape**

*Q 51 What is your opinion of the suggestion for the introduction of a European Consolidated Tape for post-trade transparency? Please explain the reasons for your views, including the advantages and disadvantages you see in introducing a consolidated tape?*

We do not see advantages for a European Tape for post-trade transparency as this will impose a significant bureaucratic burden to the industry and create a higher level of costs which in the consequence need to be re-allocated to trading houses. We recommend to keeping the most efficient option to procure data at the source, namely the market place where they are generated. Unlike equity markets where the same share is traded at many trading venues, commodity derivative contracts on energy are usually not traded in two or more exchanges at the same time.

## 5.1. Specific requirements for commodity derivative exchanges

*Q 60 What is your opinion about requiring organised trading venues which admit commodity derivatives to trading to make available to regulators (in detail) and the public (in aggregate) harmonised position information by type of regulated entity? Please explain the reasons for your views.*

We fully agree with the Commission's premise that each commodity market is different. Power markets, for instance, are distinct by the fact that electrical power cannot be stored but is depending on a special transmission system. Other commodities, such as agricultural products (e.g. wheat), do not share these features. Therefore, particularities in commodity markets cannot be adequately addressed by a one-size-fits-all approach.

As regards energy markets in particular, we do not consider these markets as excessively volatile. Though it is true that there is (sometimes even a high degree of) price volatility, this primarily traces back to the specifics of those markets. It is not necessarily caused by abusive speculative behaviour, but still a natural effect of price discovery.

Nonetheless, energy exchanges already pay close attention to the development of positions. In conjunction with high quality market surveillance, this type of monitoring is very useful and in the own interest of trading venues.

Given these considerations, we would prefer the strengthening of transparency and integrity in energy markets rather than resorting to regulatory intervention conducted in the form of position management and control. In this context, we fully support the recent Commission's legislative proposal on "Energy Market Integrity and Transparency" (REMIT). This initiative will enhance transparency for all market participants, reduce the risk of market manipulation and thus lead to further improvements as to the price formation process as such.

*Q 61 What is your opinion about the categorisation of traders by type of regulated entity? Could the different categories of traders be defined in another way (e.g. by trading activity based on the definition of hedge accounting under international accounting standards, other)? Please explain the reasons for your views.*

A kind of categorisation of traders is useful, especially with the view of the following supervision standards, permission obligations and capital requirements. However, the distinction between hedging and speculation is difficult to arrive at in practise.

A large number of trading members also are also not organized in a way that would enable them to make such distinction. From our perspective, regulatory intervention at this point would not result in reliable and useful information.

Preferably, one should seek for a differentiation between asset-backed and financial companies.



*Q 62 What is your opinion about extending the disclosure of harmonised position information by type of regulated entity to all OTC commodity derivatives? Please explain the reasons for your views.*

If the Commission decides for introducing a position reporting regime, it should also cover OTC markets – not only because on-exchange and OTC trading should be treated equally, but also because it is the OTC markets that transparency is the least developed in. Therefore, imposing position reporting requirements only for organized trading venues would not address the actual problem. In fact, it would have the opposite effect, driving more trading onto OTC markets and contradicting the objectives of the G20 commitments.

*Q 63 What is your opinion about requiring organised commodity derivative trading venues to design contracts in a way that ensures convergence between futures and spot prices? What is your opinion about other possible requirements for such venues, including introducing limits to how much prices can vary in given timeframe? Please explain the reasons for your views.*

In order to maintain confidence in and reliability of derivatives products on commodities, it is essential for the market operator that price convergence of derivatives and spot markets is ensured in the maturity of the derivatives. The danger of non-convergence could only arise from missing links to the physical underlying, either by physical delivery or references to a physical index or appropriate similar index. Before maturity of a derivatives contract, it reflects the expectations of the future price which is in case for non-storable energy not impacted by storage and capital costs.

As regards the idea of introducing limits to how much prices can vary in a certain timeframe, we do not consider these as an appropriate measure for energy markets. Following our argument developed under question 60, volatility in commodity markets can be, at times, relatively high for perfectly legitimate reasons.

At the same time, transparent and liquid markets require constant adaptation according to the needs of market participants. New contracts should be designed to meet market requirements, e.g. with respect to delivery time, contract and lot size, and delivery procedures. At the same time, contracts are continuously valued with market prices by trading participants on organized markets. Hence the difference between expected spot prices and actual derivative prices is a result of market development and reveals important information about the market itself. For example, a systematic spread between futures and spot prices clearly indicates that either buyers or sellers are willing to pay a risk premium in order to mitigate risks.

## 5.2. MiFID exemptions for commodity firms

Q 64 *What is your opinion on the three suggested modifications to the exemptions? Please explain the reasons for your view.*

Please see our general remarks under section C (page 4).

## 5.4. Emission Allowances

Q 66 *What is your opinion on whether to classify emission allowances as financial instruments? Please explain the reasons for your views.*

At present, the major part of the carbon market, namely trading in derivatives of emission allowances, is subject to financial market regulation. The same is true for derivatives on other commodities, e.g. electricity and gas, which are also covered by MiFID and MAD respectively. However, both spot trading in emissions allowances and wholesale energy markets still encounter gaps in the regulatory framework. In order to eliminate such gaps for the energy markets, the Commission has recently tabled a legislative proposal for an integrity and transparency regime for the energy markets (REMIT).

Given the significant linkages between energy and carbon trading, we would like to see a regulatory approach that comprises the same principles for all instruments on all markets for energy and energy-related products. Therefore, we are in favour of placing market oversight in spot trading of emission allowances under the realm of REMIT. This seems even more reasonable, as not all companies with an obligation under the EU ETS – in particular smaller compliance buyers – have the required capacity and expertise in the financial field which was required by MiFID rules. However, all arguments should be carefully considered in the upcoming consultation process, including the proposal to classify emission allowances as financial instrument.

For the functioning of the Emission Allowances Market it should also be considered to align the settlement procedures of transactions in Emission Allowances. There has been a level of uncertainty in the Market concerning the treatment of “stolen” Emission allowances. In Germany for example even stolen certificates are merchantable after having been registered in the national registry. This is in order to protect the confidence of buyers and sellers not to be obliged to reverse the transaction if, unknown to the parties, at one point in the chain of commerce criminal activities were involved. This approach, which is in line with a former draft of the establishment of a European Emission Trading scheme, was chosen to secure the functioning and the trust in the Emission Allowances Market. In other European countries for instance Great Britain there are no rules of such clarity. Thus, for the same European Emission Allowance it is perfectly legal to be traded in Germany and of questionable legality in England. This status of uncertainty has a remarkable negative influence and maybe a big impact on

the functioning of the Emission Allowances Market. For the functioning of the internal market the commission should provide for a unified regime in this regard.

## 9.2. Stronger oversight of positions in derivatives, including commodity derivatives

*Q145 If regulators are given harmonised and effective powers to intervene during the life of any derivative contract in the MiFID framework directive do you consider that they could be given the powers to adopt hard position limits for some or all types of derivative contracts whether they are traded on exchange or OTC?*

From our perspective, it seems premature to discuss the introduction of interventionary powers even before detailing the type of behaviour that is actually sought to be restricted. Before considering the introduction of new powers it should be clearly developed what they aim at and a consultation should be carried out on these details.

We therefore do not support the adoption of position limits. There is a risk that position limits damages the market in the form of squeezes. It must be recognized that such intervention affects the hedgers significantly and, again, it is difficult to differentiate between hedging and non-hedging activities. Also, one must distinguish between physical delivery and cash delivery.

In case that the Commission decides for new powers given to the regulators to adopt position limits, such powers must cover contracts traded on exchange as well as OTC. Otherwise such measures could have the effect of driving trading onto OTC, thus resulting in even more trading escaping the regulatory interventions. This, in turn, would leave such interventions even less efficient.

*Q146 What is your opinion of using position limits as an efficient tool for some or all types of derivative contracts in view of any or all of the following objectives: (i) to combat market manipulation; (ii) to reduce systemic risk; (iii) to prevent disorderly markets and developments detrimental to investors; (iv) to safeguard the stability and delivery and settlement arrangements of physical commodity markets. Please explain the reasons for your views.*

As already mentioned under questions 60 and 145, we do not consider position limits as an appropriate measure, since we do not see any alarming building-up of positions. Nevertheless, we fully support the Commission's intention of taking measures to reduce systemic risk (ii). In this context, we would particularly like to stress the usefulness of central clearing of derivatives contracts. It seems preferable to refrain from engaging in the introduction of powers on position limits, when another efficient measure is already about to be implemented.

*Q147 Are there some types of derivatives or market conditions which are more prone to market manipulation and/or disorderly markets? If yes, please justify and provide evidence to support your argument.*

No. As a general rule, the better market surveillance is in place, the least risk for market manipulation and/or disorderly markets exists. Hence, trading which takes place on regulated markets and MTFs should be the safest, while OTC trading imposes the largest risks. Measures incentivizing both transparent trading and central clearing should be prioritized.