

**Response to CESR`s Draft Technical Advice
on possible Implementing Measures of the Directive 2004/39/EC on Markets in Finan-
cial Instruments
of the BaFin-Group German Energy Market
2nd Set of Mandates / Consultation Paper of October 2004**

I. Introduction

The Directive on Markets in Financial Instruments (Directive 2004/39/EC – MiFID) provides for the Lamfalussy Procedure, meaning the Commission shall adopt implementing measures with respect to a number of provisions of the Directive. Before the Commission presents its proposal for implementing measures it seeks technical advice on these measures from the Committee of the European Securities Regulators (“CESR”). In response to the Commission’s mandate CESR prepared a Draft Technical Advice which it made public in October 2004. CESR invited interested circles to respond to its Draft Technical Advice until January 21, 2005. CESR’s Draft Technical Advice addresses inter alia certain definitions of Article 4 and Annex I Section C of the MiFID which determine the scope of application of the MiFID and in particular its extension to commodity derivatives.

The energy market companies which are members of the BaFin-Group German Energy Market are aware that the Draft Technical Advice takes into account many of the specifics of the energy market and we hence basically welcome the approaches of the Draft Technical Advice concerning the energy market. However, we prepared this paper in response to CESR’s Draft Technical Advice thereby commenting on those questions and suggestions which are linked to the definition of “for commercial purposes”, “commodities”, characteristics of derivatives and investment advice to address and further emphasise these specifics in order to achieve an appropriate Technical Advice concerning our businesses.

II. Response to CESR`s Draft Technical Advice

1. Definition of investment advice (Art. 4 (I) no. 4 MiFID)

Extract from MiFID - Article 4 (1) no. 4:

“Investment advice” means the provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments.

Extract from the mandate from the Commission:

DG Internal Market requests CESR to provide technical advice on possible implementing measures on the definition of “investment advice” and in particular on the criteria for differentiating a personal recommendation from

- general recommendations,
- marketing communications,
- information given to the clients or from

- simple offers,
- the activities carried out by tied agents.

a) Advice on the use of a certain type of service

CESR considered whether advice on the use of a "service" (e.g. advice on the merits of using a particular broker or investment manager) should be covered by the term "Investment advice". It asks therefore in Question 1.1:

1.1 Do you agree that advice on services, such as the recommendation to use a particular broker, fund manager or custodian, should not be covered?

Our response: We agree that advice on certain kinds or types of services, such as services of a broker or market maker, should not be covered by "investment advice". The inclusion of the service advice into the "investment advice" would go beyond the scope of Article 4 (1) no. 4 MiFID which relates to the provision of personal recommendations about one or more transactions relating to financial instruments. The decisive criterion for "investment advice" is the personal recommendation which has a relation to a financial instrument.

b) The term "personal"

CESR explained its opinion about the meaning of the term "personal" information in contrast to general impersonal information. CESR recognized that personal implies that the expression, hint, information, advice has to have a certain relation to a client's or customer's specific situation. On the other hand CESR opined that "personal" could also mean a kind of "personal relationship" between the service provider and the customer. It asks therefore in Question 1.2:

1.2 Do you agree with the approach that a personal recommendation has to be held out as being suited to or based on a consideration of the client's personal situation or do you consider this criterion to be unnecessary or ambiguous and would like to refer to the bilateral nature of the relationship and bilateral contact between the firm and its client? In the latter case which criteria would you use to differentiate between a "personal recommendation" and a "general recommendation" or a "marketing communication"?

Our response: We think it is necessary that a personal recommendation is based on a consideration of the client's circumstances and is being suited to the client's specific situation. If we do not have this concept of "personal", there will occur remarkable difficulties in distinguishing general marketing activities, simple offers and advertising information aimed at certain clients (which can also be rendered on basis of a personal relation) from a personal recommendation in the meaning of the MiFID's "investment advice".

However, the existence of a bilateral relationship between the firm and the client, may it be personal, by email or by telephone, could be a first indication in the determination process between an investment advice in the meaning of the MiFID and other kind of information provided for clients. But the sole existence of a bilateral relationship between a firm and a client should not be the decisive criteria for considering a communication between a client and a firm as investment advice in the meaning of MiFID.

c) One or more transactions relating to financial instruments

CESR considered further if generic information should be covered by "investment advice". Generic information means a wider range of investment information such as general financial planning and asset allocation. Such a broad definition could - according to CESR - enhance investor protection and prevent some market distortions between (licensed) firms rendering specific advice related to financial instruments and other firms rendering generic financial

information. CESR thinks the broader as well as the narrower interpretation could be possible under Art. 4 (1) no. 4 MiFID. It therefore asks in Question 1.3:

1.3 Do you think it is reasonable to restrict "investment advice" to recommendation of specific financial instruments or is it necessary to cover generic information including financial planning and asset allocation services for financial instruments?

Our response: We think generic information such as financial planning and asset allocation services should not be regarded as investment advice. In consideration of the Article 4 (1) no. 4 MiFID we think the concept of the financial service "investment advice" should be restrained to transactions in financial instruments. If investment advice could also be any general information related to financial planning without addressing a specific transaction or transactions in financial instruments it would exceed the scope of the definition in Article 4 (1) no. 4 MiFID.

d) Contract

CESR is of the opinion that a contractual relationship with the client should not be prerequisite for the provision of investment advice. CESR bases its opinion on the fact that some jurisdictions provide for concepts such as pre-contractual liability or implied agreements without consideration while others do not. The conditions for the formation of a contract and liability vary according to the relevant jurisdiction. However, CESR recognizes that the actual existence of a contract between the firm and the client about "continuous investment advice" could constitute a strong indication and will be one of the factual circumstances which will be considered for the assessment whether investment advice is being provided.

Our response: We think that the existence of a contract should be a prerequisite for the decision whether investment advice is being rendered. Investment advice in the meaning of Article 4 (1) no. 4 MiFID shall be a financial service. It is very unlikely that a financial service is being rendered without having the expectation of consideration, meaning not to have any contractual basis on grounds of which the service is being rendered. A contractual relationship is in both roman as well as common law jurisdictions generally considered as the basis for an exchange of services or goods against consideration. The distinction between personal recommendation and general information, marketing activities or simple offers should take into consideration the existence of a contract. A personal recommendation shall be rendered for consideration whereas adverts, marketing offers and other forms of general information are generally provided for free. If, however, a contractual relationship is not seen as a constitutional requirement for investment advice the existence of a contractual relationship between the investment firm and the client could at least constitute a strong indication in the assessment whether investment advice is provided or not.

e) CESR's Draft Level 2 Advice - Definition of investment advice (Box 1)**Definition of Investment advice**

1. „*Personal recommendation*“ means any information given to a person including a value judgement or opinion or any other express or implicit recommendation whether to a) by, sell, subscribe for, exchange, redeem, hold or underwrite one or more *[specific]* financial instruments or b) to exercise, or not to exercise, any right conferred by one or more *[specific]* financial instruments to buy, sell or subscribe for one or more financial instruments, or c) to carry out any other transaction relating to one or more *[specific]* financial instruments that is held out, either explicitly or implicitly, or the recipient as being suited to, or based on a consideration of, his personal circumstances ~~[or is made in a bilateral communication or relationship]~~.

Question 1.2 – *Do you agree with the approach that a personal recommendation has to be held out as being suited to, or based on a consideration of, the client's personal situation or do you consider this criterion to be unnecessary or ambiguous and would like to refer to the bilateral nature of the relationships and bilateral contacts between the firm and its client? In the latter case which criteria would you use to differentiate between a “personal recommendation” and a “general recommendation” or a “marketing communication”?*

Question 1.3. – *Do you think it is reasonable to restrict “investment advice” to recommendations of specific financial instruments or is it necessary to cover generic information including financial planning and asset allocation services for financial instruments?*

2. In comparison with personal recommendation, most “*general recommendations*” are neither explicitly nor implicitly held out as being suited to, or based on a consideration of, the client's personal circumstances.
3. In comparison with personal recommendation, most “*marketing communications*” are not held out as being suited to, or based on a consideration of, the client's personal circumstances and is issued to the public. “*Marketing communication*” is generally not issued on a client's request but at the initiative of the investment firm.
4. In comparison with personal recommendation “information given to the client” is generally factual information that is neither held out as being suited to, or based on a consideration of, the recipient's personal circumstances, nor does include any comment or value judgement in respect of one or more *[specific]* financial instruments or specific transactions or is intended to influence the client in this respect.
5. In comparison with personal recommendation, an “offer” will generally lack a value judgement or other recommendation in respect of one or more transactions in financial instruments and will generally not be held out as being suited to the recipient's personal circumstances.
6. Though these terms can be differentiated from “*personal recommendation*” by the criteria mentioned above, there may be overlaps. It is therefore necessary to determine whether, based upon a consideration of all the relevant circumstances, the test set out in paragraph 1 is satisfied. If this is the case, each relevant regime will be applicable.

Our response to the Draft Level 2 Advice – Definition of investment advice (Box 1) - Recommendations

With respect to the definition of investment advice we **recommend to include the term “specific” in square brackets** into the definition. We think it is important to relate investment advice to individualized financial instruments and not to financial instruments in a general meaning. If a personal recommendation has no relation to a “specific” financial instrument but to financial instruments in general the definition would reach into the field of general information, adverts, marketing offers and thus go beyond the concept of investment advice.

We do not recommend to include the term written in square brackets **“or is made in a bilateral communication or relationship”** into the definition of investment advice. As mentioned already in response to CESR's question 1.2 above we think that a bilateral relationship or communication between a firm and a client could be a first indication in determining whether a certain interaction between a firm and a client is investment advice or not. But it should not be a decisive criterion for this determination. This would lead to a very broad definition of investment advice which would cover eventually also forms of general information.

2. List of financial instruments (Article 4 – Annex I Section C MiFID)

Extracts from Level 1 text MiFID:

Article 4: Definitions

(1) Nr. 2 “Investment services and activities” means any of the services and activities listed in Section A of Annex I relating to any of the instruments listed in Section C of Annex I;

The Commission shall determine, acting in accordance with the procedure referred to in Article 64(2):

- the derivative contracts mentioned in Section C 7 of Annex I that have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognized clearing houses or are subject to regular margin calls*
- the derivative contracts mentioned in Section C 10 of Annex I that have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognized clearing houses or are subject to regular margin calls;*

Annex I Section C – Financial instruments:

(7) Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C.6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognized clearing houses or are subject to regular margin calls;

(10) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognized clearing houses or

are subject to regular margin calls.

Extract from the Commission's mandate:

DG Internal Market requests CESR to provide technical advice on possible implementing measures on following issues:

(1) A definition of commodity.

a) The definition of the term "commodity"

CESR thinks that it is neither feasible nor helpful to provide an exhaustive list of commodities for the purpose of the MiFID. Instead the MiFID should take a more general approach in defining this term.

Our Response: We think this approach is preferable and we strongly support CESR's intent to exclude from the term "commodity" intangibles, such as rights, allowances, storage capacity and weather indices.

b) The treatment of intangibles

CESR thinks that "commodities" in the meaning of MiFID should be limited to goods. CESR bases its concept of the term "commodity" on the assumption that Annex I Section C, no. 10 indicates that intangibles as mentioned in no. 10 shall not be considered as commodity under MiFID. However, CESR asks in its Questions 2.1 and 2.2:

2.1 Should commodities for this purpose [meaning the purpose of defining financial instruments in section C, no. 7 and 10] be limited to goods?

2.2 Alternatively, should an approach be taken that permits, rights or property specifically mentioned in C (10) and other intangibles to be treated as "commodities" as well?

Our response: We propose that the term commodity should be defined in its generally accepted meaning which would limit the term to goods. This is the concept which is also shown in the several definitions from the online dictionary included in the Annex to CESR's draft technical advice on page 37. The extension of the term commodities to intangibles such as permits, rights or physical features such as heat or steam would go beyond the generally accepted meaning of a commodity. The extension would make Annex I, Section C, no. 10 oblivious. Nevertheless we think that electricity supplies should be considered and treated as goods for the purpose of MiFID. This is in line with the view of the European Court of Justice which considers electricity as a commodity.

c) The meaning of delivery and trading

CESR asks further with respect to the term "commodity" whether the commodity must be eligible for delivery meaning the physical movement from one point to another. CESR does not take "physical delivery" as necessary for a commodity. It highlights other forms of transfer of ownership common on the respective commodity markets. CESR asks further whether the term commodity should only embrace goods which can be traded on liquid markets. CESR did not propose such a limitation instead asks for views in its Questions 2.5 and 2.6:

2.5 If the definition of "commodities" is restricted to goods should the requirement be imposed that there must be liquid market in the underlying?

2.6 If not, should a requirement be imposed that in addition to being capable of delivery the underlying must be capable of being traded and if so should there be a requirement of a liquid market?

Our response: CESR opines that commodities are standardised fungible products. The feature of fungibility allows the trading in large volumes with high trade frequencies. The term "Liquid market" stands exactly for large volume and high frequency trade. If the liquid market shall not become a requirement for the "commodity" a commodity should at least theoretically be capable of being traded in high volumes and with high frequencies. Therefore we suggest that in CESR's Draft Level 2 Advice in Box 2 the definition of "commodity" should be supplemented as follows:

"The concept of a "commodity" should cover any goods of a fungible nature which are capable of being delivered *and traded in high volumes and with frequency on national and/or international markets.*"

We further suggest that the wording in CESR's Draft Level 2 Advice Box 2, lit. (d) should be amended as follows:

"energy supplies (such as oil, coal, gas their *processed* products and electricity); and"

The substitution of the term "derivative" by "processed" excludes the possibility of misconceptions of the term derivative.

We further suggest that the last sentence of CESR's Draft Level 2 advice in Box 2 is being amended as follows:

"The concept of commodity" should not include services or other items which are not goods (such as land or currencies), entirely intangible (*such as cold or heat*) or involve only the transfer of rights *or allowances, such as emission allowances, storage, transmission or pipeline capacity.*"

We think the supplements are useful to make it quite clear that none of the different types of intangibles are covered by the term commodity. Regarding the importance of emission allowances and the emerging trade in them we would also recommend to expressly mention them in this list so that no doubt may arise that emission allowances are no commodities in the meaning of MiFID.

d) CESR's Draft Level 2 Advice - Definition of commodity (Box 2)

BOX 2

The concept of a "commodity" should cover any goods of a fungible nature which are capable of being delivered **and traded in high volumes and with frequency on national and/or international markets.**

For these purposes, goods may include raw materials, derivative products, by-products and standardised goods.

Examples of things which would be considered as commodities include (but are not limited to) things of the following types:

- (a) precious metals (including gold and silver) and their ores and alloys;
- (b) base metals (such as iron, lead, copper, zinc, tin, aluminium) and their ores and alloys;
- (c) agricultural products (such as cocoa, sugar, grains, coffee, tea, fruit, livestock, livestock)

products, non-mineral oils and fats);

(d) energy supplies (such as oil, coal, gas, their **derivative processed** products and electricity); and

(e) raw materials (such as timber, cotton, jute, rubber and sisal).

The above groupings of commodities are solely intended for the purpose of illustration and are not intended to have wider significance.

For the purposes of the definition of "commodity": "delivery" should be one of:

(i) physical delivery of the relevant goods themselves;

(ii) delivery of a document showing title to the relevant goods (or relevant quantity of the goods concerned); or

(iii) another method of transferring ownership of the relevant quantity of goods without physically delivering them (including notification of a trade to the operator of an energy supply network) and which entitles the recipient to production of the relevant quantity of the goods without more; and

"fungible" means that, for the purposes of an obligation, a unit of that asset of the relevant description is indistinguishable and wholly interchangeable with another unit of the same asset and description.

The concept of "commodity" should not include services or other items which are not goods (such as land or currencies), entirely intangible or involve only the transfer of rights, such as transmission or pipeline capacity **or allowances, such as emission allowances, storage, transmission or pipeline capacity.**

Our response to the Draft Level 2 Advice – Definition of investment advice (Box 1) – Recommendations

With respect to the reasons set forth above we **recommend to supplement** the **introductory sentence** to make sure that the **liquidity aspect** is addressed to in the Level 2 Advice.

We also recommend **replacing the term “derivative”** under (d) **with the term “processed”** to avoid misinterpretations.

For the sake of clarification we also recommend the **supplement of the final sentence.**

3. Commercial purpose and characteristics of other derivative financial instruments (Annex I Section C MiFID)

Extract from the Commission's mandate:

DG Internal Market requests CESR to provide technical advice on possible implementing measures on following issues:

(2) The conditions under which an option, future, swap, forward rate agreement or other derivative contract related to commodities (which can be physically settled and is not otherwise covered by Section C no. 6) should be determined not to be for a commercial purpose.

(3) The conditions (other than cleared and settled through recognized clearing houses or subject to regular margin calls) for considering when a derivative contract of the type included in Annex I Section C no. 7 has the characteristic of other derivative financial instruments.

CESR proposes to address the two questions (2) and (3) together. Notwithstanding the fact that the following remarks are made against the background of the approach proposed by CESR, we suggest that CESR re-considers whether or not the commercial purpose test and the characteristics of other derivatives test should be merged. Some transactions may evidently only fulfill one of the two criteria. Hence the test whether or not such transactions would fall under the scope of C (7) may be facilitated and may be more transparent if the tests are applied separately.

a) Treatment of spot transactions

CESR recognizes that a specific transaction can be a derivative instrument in one case whereas in another case it is a simple transaction depending on whether it is for commercial purposes or not. The key for distinguishing between "for commercial purposes" and "not for commercial purposes" is the business intention of a party. The business intention has to be determined on basis of the existence of some main factors which are supported by several indications. One determining factor shall be the existence of spot contracts. CESR recognizes this criterion as important in distinguishing between derivative transactions and others but points out that the generally accepted settlement periods vary remarkably between several spot markets. CESR proposes as a compromise a preliminary filter that only applies if the settlement period does not exceed (a) the lesser of two business days and (b) the generally accepted settlement period in the relevant market. It asks for comments to this approach in its Question 2.7:

2.7: Should there be an initial filter to exclude contracts which are likely to be spot contracts? If so, do you agree with the proposed approach of excluding contracts whose settlement period does not exceed the lesser of two business days and the generally accepted settlement period in the relevant market?

Our response: Defining spot transactions as "filter" is generally absolutely welcomed. This enables companies to carry out transactions in certain fields without additional legal check. As a consequence, the financial burden on companies is considerably reduced. However, with regard to the settlement period of spot transactions it has to be noted that the period mentioned [the shorter period of a) two business days and b) the generally accepted settlement period for the relevant market] is considered too short. Against the background of the 7 day test in the UK, the companies active in our working-group also propose to expand the spot definition to 7 days or 5 business days. Even in this settlement period it is not possible – at least not in the energy market - to speculate significantly. Should CESR act on the assumption that this regulation cannot be extended to other commodities, we propose to introduce a special regulation for the energy industry. In our opinion possible risks could be easily

eliminated by expanding the spot period to the lesser of a) 5 business days or b) the generally accepted settlement period in the relevant market. As a result it would be possible to accept a 7 day or 5 business day spot period in the energy market. In other markets spot definitions would then automatically reduce their scope. By the way, such a determination of spot periods would also make more sense when one considers that the second criterion of the general settlement period in the relevant markets would also gain in independence and importance: With regard to the current determination (2 days or the shorter actual settlement period) this criterion is not very significant and does not considerably improve investors' protection.

The comparability with "other derivative financial instruments" as demanded in Annex 1 paragraph c) no. 7 of MiFID speaks also for our recommended extension of the spot definition. Even due to the specifics of the energy market there is no such comparability with a settlement within 7 days / 5 business days.

Moreover, it has to be taken into account that as a rule in many energy markets (e.g. the coal market) settlement is not possible within two days due to the fact that commodities have to be shipped. These markets could not make use of the spot market privilege.

b) Intention to deliver

CESR recognizes that the intention to deliver a certain commodity could be an indication that the transaction is for commercial purposes and thus not a derivative transaction. CESR is aware of the difficulty in practice to verify whether the intention to deliver exists or not.

Our response: We agree that the intention to deliver a certain commodity respectively to accept the delivery of the commodity is a key factor for a transaction having a commercial purpose. We therefore agree with CESR's approach to use the parties' intention to deliver as a factor for the ascertainment that a transaction has been concluded for commercial purposes.

c) Producers, users and commercial merchants

It has been suggested in several responses to CESR's Call for Evidence released in early summer that it should be looked at the status of the parties to a transaction for determining whether a transaction has a commercial purpose. It means if a party is a producer, consumer or commercial merchant of a commodity it is an indication that the transaction is for commercial purposes. CESR thinks that this criterion can be of relevance where a party which is a producer/consumer or merchant of a commodity enters into a contract for the purpose of hedging an exposure to the underlying but does not intend to take delivery of the underlying. This would presuppose that hedging an exposure is a commercial purpose. CESR makes also a reference to Articles 2 (1) (i) and (k) of MiFID which exempt parties carrying out certain types of business from the MiFID. CESR thinks it might be somewhat duplicative to bring this criterion up on one hand in determining the scope of application of the MiFID and on the other hand also in the determination if a transaction has a commercial purpose. CESR thinks also to what extent this criterion could be applied, only to suppliers and users or also to merchants of a commodity. CESR asks therefore in the following questions 2.8 and 2.9:

2.8: *Should the status of the parties to the contract only be relevant for determining whether the exemptions in Article 2 (1) (i) and (k) apply or should it also be taken into consideration as an indicative factor for determining whether there is a commodity derivative as opposed to a commercial contract for the supply of commodities?*

2.9: *Should commercial merchants be required to rely on the intention to deliver test or should the producer and user indicating factor apply to them as well? If so how can a commercial merchant be differentiated from a speculator?*

Our response: We think the status of the parties to the contract should also be relevant for determining whether there is a commodity derivative as opposed to a commercial contract for the supply of commodities. In some sectors, for instance under circumstances in the energy sector, a permit is required by suppliers of energy. If a party to a transaction does not have such a permit it is at least an indication that the transaction does not have a commercial purpose but could have been concluded for speculative objectives. And even in markets where a specific permit for market players is not necessary it is in most cases easy to ascertain to which branch or business sector a party to a transaction belongs. If an institutional investor concludes commodity transactions it is relatively unlikely that this party is interested or expects the delivery of the respective underlying. In this case it would be an indication that this transaction is not for commercial but for speculative purposes and accordingly could be a derivative instrument.

A merchant as such can conclude transactions with different objectives. On the one hand we find merchants who provide and deal with financial instruments having as underlying certain types of commodities on the other hand there are merchants who purchase and sell the real commodity. Notwithstanding the ambiguity of the term merchant in this respect, we suggest in response to question 2.9 that the status criterion should be applied to *commercial* merchants, too. A commercial merchant can be differentiated from a speculator by means of an analysis of its portfolio of instruments and contracts and/or its market appearance. If the contents of the portfolio and/ or the perception of the merchant by other market members suggest that the merchant is a person that concludes commodity transactions in order to physically fulfill these transactions it can be qualified as a commercial merchant. The application of the status test to commercial merchants would, however, enhance the significance of the intention to deliver test with regard to commercial merchants, as, due to the ambiguity of the term merchant set forth above, a change of business seems a bit more likely as with regard to producers and consumers of a commodity. We believe that the intention to deliver test can be applied to such merchants without any problems. In addition, it should be made clear in this context in Box 3 under no. 3 lit. (a) that also affiliates of producers which have been sourced out due to unbundling reasons are considered to be producers for the status test whereas the enhanced significance of the intention to deliver test regarding commercial merchants set forth above should hold true here as well.

d) What is decisive - the status of both or the status of just one party?

In context with the questions 2.8 and 2.9 above CESR thinks further if the additional status test for producers, users or merchants is applied whether it is relevant if only one party fulfills the criterion or if both parties must fulfill the status criterion. It asks therefore in question 2.10:

2.10: *Do you agree with an approach under which the status of the contract for both parties is based on a consideration of the status and/or intent of either of the parties?*

Our response: We agree with the approach under which the status of a transaction shall be based on the consideration of the status and/or intent of either of the parties. We recognize the difficulty to determine the characteristic of a transaction if one party may have concluded it for commercial purposes but the other for non-commercial (speculative) purposes. In that case it should be determined from each party's point of view separately.

e) CESR's Draft Level 2 Advice – Commercial purpose (Box 3)

BOX 3

Certain factors should be regarded as determinative of whether a contract (which would otherwise be a financial derivative contract) is or is not made for commercial purposes and has the characteristics of other derivative financial instruments, while others are merely indicators. When only indicative factors are present, all of those must be considered and the over-

all picture based on those indicators taken as the result – indicative factors should be considered to have equal weight.

(1) A contract not falling within Annex I, paragraph C(6), is to be regarded as made for commercial purposes and as not having the characteristics of another derivative financial instrument, if under the terms of the contract –

(a) delivery is to be made within the lesser of:

(i) ~~two~~ **five** business days; and

(ii) the period generally accepted in the relevant market as the standard delivery period,

unless it can be shown that there existed an understanding that (notwithstanding the express terms of the contract) delivery would not be made within that period; or

(b) the contract is with or by the operator of an energy transmission grid or pipeline network, and is either to ensure security of energy supplies or is necessary to keep in balance the supplies and uses of energy at a given time.

(2) A contract not falling within Annex I, paragraph C(6), is to be regarded as not made for commercial purposes and having the characteristics of another derivative financial instrument if the parties do not have both the legal capacity, and any necessary permits or licences, to make or take delivery of the commodity to which the contract relates.

(3) The following are indications that a contract (outside Annex I, paragraph C(6), and outside (1)) is made for commercial purposes, and does not have the characteristics of an other derivative financial instrument –

(a) one or more of the parties is a producer **or a commercial merchant** of the commodity or uses it in his business;

(b) the seller delivers or intends to deliver the property or the purchaser takes or intends to take delivery of it, determined as at the moment of formation of the contract, where the following are indicators of the intention –

(i) the terms of the contract as set out explicitly between the parties;

(ii) any other terms of the contract, whether implicitly agreed between the parties or implied by law or custom or practice in the relevant market;

(iii) any course of dealings between the parties;

~~(iv) any history of behaviour in relation to equivalent transactions with other parties;~~

Question 2.11 – *If both elements of (2) are present should this be conclusive or indicative? If indicative, if only one is present is that still an indicator?*

(4) The absence of the factors in (2) is an indication that a contract (outside Annex I, paragraph C(6)) is not made for commercial purposes and that it has the characteristics of another derivative financial instrument.

(5) It is an indication that a contract is made for commercial purposes, and that it does not have the characteristics of another derivative financial instrument, that the price, the lot, the delivery date or other terms are determined by the parties for the purposes of the particular contract and not by reference (or not solely by reference) to regularly published prices, to standard lots or delivery dates.

(6) The following are indications that a contract is not made for commercial purposes, and that it has the characteristics of another derivative contract –

(a) it is traded on a third country marketplace or trading facility **comparable to regulated markets according to Article 4 para. 1 Nr. 14 of the Directive 2004/39/EC on Markets for Financial Instruments**;

(b) it is expressed to be as traded on an organised market – that is a regulated market, MTF or third country marketplace or trading facility – even though not traded on the organised market concerned);

(c) performance of the contract is enforced by an organised market (as described in (a)) or a clearing house;

(d) there are arrangements for the payment or provision of margin;

(e) neither party is a producer, commercial merchant or user of the commodity;

(f) neither party expects to have a net (or gross) obligation for immediate physical delivery of the commodity at any time.

Our response to the Draft Level 2 Advice – Commercial purpose (Box 3) – Recommendations

With respect to no. (1) by virtue of which the spot contracts shall be excluded from the scope of “other derivative instrument” we mentioned already above that the settlement period should be extended to seven days because this period opens the possibility to have spot contracts excluded from the scope of MiFID to commodity markets with a settlement period for spot transactions of more than two days. For this reason we suggest to amend the two-business-day period in no. (1) para. (a), (i) of the Draft Level II Advice in Box 3. Instead of a two-business-day period we suggest a seven-day period.

With respect to question 2.11 (*If both elements of (2) are present should this be conclusive or indicative? If indicative, if only one is present is that still an indicator?*) we think that the presence of both criteria mentioned in no. (3) [we presume the question refers to (3) because it is placed right after (3)] should be conclusive whereas the importance of the intention to deliver test should be of a greater importance with regard to commercial merchants or subsidiaries of producers as it is with regard to producers or end users. With regard to producers or end users the indication of the first element should be strong enough to only be contradicted in cases where an intention to deliver is obviously not given.

With regard to the second question we think that the fulfillment of one element only should still be an indication as this sufficiently evidences that the contracts are concluded for a commercial purpose. Moreover, the fulfillment of the intention to deliver test only should be regarded as conclusive as the qualification as derivative is not justified in this case because such transactions are regularly not concluded with a speculative purpose.

We suggest deleting the criterion in Box 3, no. 3 lit. (b) (iv) because it is very abstract and requires a party to a transaction to verify the history of behaviour of its counterpart in former transactions. This is in our view not feasible in practice.

The wording in Box 3, no. 6 (a) should be supplemented by the following phrase: "*comparable to regulated markets according to Article 4 para. 1 Nr. 14 of the Directive 2004/39/EC on Markets for financial Instruments*". This supplement secures that only transactions which are traded on markets with common standards come under the MiFID.

In Box 3 under no. 6 (e) it reads: "*neither party is a producer, commercial merchant or user of the commodity*". This paragraph shall be an indication that a transaction is not for commercial purposes. This is somewhat contradictory to the stipulation under no. 3 (a) in Box 3. In order to align no. 3 (a) the commercial merchant should be introduced there as well, whereas in this case no. 3 (b) should still apply in order to, as set forth above, enable a differentiation between a commercial merchant and a speculator.

4. Definitions and other categories

a) Definition of climatic variables, freight rates, emission allowances, inflation rates and official economic statistics

Extract from the Commission's mandate:

DG Internal Market requests CESR to provide technical advice on possible implementing measures on following issues:

(4) The definition of climatic variables, freight rates, emission allowances, inflation rates, official economic statistics.

CESR's Draft Level 2 Advice in Box 4 reads:

The terms used in Annex I, paragraph C (10) are sufficiently certain and understandable, so that implementing measures for their definition are necessary.

Our Response: We agree with CESR's approach that emission allowances having been purchased for the compliance with the Article 12 para. 3 of the Directive of the European Parliament and Council of October 13, 2003 regarding the system for the trade with greenhouse gas emission certificates in the European Union and the amendment of Directive 96/61/EC of the Council (Emissions Trade Directive) or any other comparable system should not be considered as emission allowances in the meaning of the MiFID. But maybe it would be preferable to make this quite clear by introducing a sentence as follows in the Draft Level 2 Advice to the definitions of emission allowances:

"Emission allowances or other emission rights capable of being applied for compliance purposes under the system for the trade with greenhouse gas emission certificates in the European Union or any other comparable system which are purchased for compliance purposes under these systems are not emission allowances in terms of the MiFID".

Such a clarification is necessary against the background that it is not clear from the first look whether certain transactions involve a transfer of an asset or only the transfer of a right.

b) Other categories of assets, rights, obligations, indices and measures

Extract from the Commission's mandate:

DG Internal Market requests CESR to provide technical advice on possible implementing measures on following issues:

(5) Whether there are, at this time, other categories of assets, rights, obligations, indices and measures not otherwise mentioned in Section C, where contracts relating thereto should be determined to fall within Section C.10. CESR should explicitly detail those categories.

c) CESR's Draft Level 2 Advice - Definitions and other categories (Box 5)

BOX 5

Derivative contracts relating to emissions allowances that are settled by amendment of the parties' position on the applicable register of emissions allowances should also be capable of falling within section C (10).

Other specific categories of assets, rights, obligations, indices and measures not otherwise mentioned in Section C, where derivative contracts relating thereto should be determined to fall within Section C.10 are derivative contracts relating to the following:

- (1) telecommunications bandwidth;
- (2) commodity storage capacity;
- (3) transmission capacity, whether cable, pipeline or other means;
- (4) allowances, credits, permits, rights or similar assets which are directly linked to the supply, distribution or consumption of energy derived from renewable resources.

AND (IF A MORE FLEXIBLE SET OF CRITERIA IS ADOPTED AS AN ADDITIONAL CATEGORY

(5) assets, rights, obligations, indices and measures that have each of the following characteristics:

- (a) the asset, right or obligation is transferable, whether or not physical delivery or an equivalent mechanism of delivery is applicable, or, in the case of an index or measure its underlying constituents are similarly transferable;
- (b) historical information about the prices or values of the relevant asset, right or obligation, or the data used in the construction of the relevant index or measure, is publicly available;
- (c) (if relevant) the manner in which the index or measure is constructed is published, so that the index or measure is readily verified, whether or not the index or measure is calculated and published by a third party; and
- (d) the price, value or data (of the sort referred to in (2)) is available on an ongoing, regular and sufficiently frequent basis so as to provide transparency of pricing of any derivative contract.]

Our response: We think an abstract advice as given under no. (5) is sufficient. It is a flexible approach to cover derivative financial instruments as they will develop in future.

d) 3.1 (6) Characteristics of other derivative financial instruments

Extract from the Commission's mandate:

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30 / 04/ 2005 on following issues:

(5) The conditions (other than cleared and settled through recognized clearing houses, subject to regular margin calls or traded on a Regulated Market or an MTF) under which an option, future, swap forward rate agreement or other derivative contract relating to the underlying referred to in 4 and, if any, in 5 above should be determined to have the characteristics of other derivative financial instruments where the contract must be settled in cash or may be settled in cash at the option of one of the parties – otherwise than by reason of a default or other termination event-)

CESR's Draft Level 2 technical advice / Box 6:

A derivative relating to a "specified other underlying" will have the characteristics of other derivative financial instruments if:

- it is settled in cash or may be settled in cash at the option of one or more of the parties (otherwise than by reason of a default or other termination event);
- it does not fall into the above category, but is traded on a regulated market and/or an MTF; or
- it does not fall into either of the above categories but is not a contract for a commercial purpose and has the characteristics of other financial instruments, where both such concepts are interpreted in the same way as for section C (7), with the necessary modifications in the case of an intangible underlying, to reflect the fact that settlement may involve a different mechanism to delivery (such as the assignment or novation of a contract or the amendment of a register).

For these purposes "specified other underlying" means those types of property, rights or obligations considered in the advice under paragraphs 3.1(4) and (5) above, that is climatic variables, freight rates, emission allowances, inflation rates and other official economic statistics, as well as telecommunications bandwidth, commodity storage capacity and transmission capacity, renewable energy credits [and underlyings satisfying the criteria specified in paragraphs 5 (a) to (d) of the advice under mandate 3.1 (5)].

Our response: We agree with this proposal in general and want to make the following remarks:

We support the approach of taking into account the commercial purpose of the transactions falling under the scope of C (10), as this approach ensures a parallel and consistent understanding of derivatives in terms of C (7) and C (10). In this respect we emphasize especially that a non-recognition of the commercial purpose within C (10) could possibly lead to the result that a transaction concerning the delivery of energy market commodities (such as gas or oil) would not be regarded as derivatives in terms of C (7) because being made with a commercial purpose whereas a transaction concerning the storage of the purchased commodity would not necessarily be excluded from the scope of C (10) because of the lack of the criterion "commercial purpose" there.

Berlin, 27.01.2005

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