

Consultation Paper

CESR Technical Advice to the European

Commission in the context of the MiFID Review

(Client Categorisation)

– Response of the ECT-Group –

I. Introductory Comments

We are representing the Energy Commodity Traders Group ("ECT-Group"), a group of mostly German energy trading firms which established a joint working and discussion group for the exchange of experiences in financial and physical energy trading and for the co-ordination of the communication with German and European authorities. We would like to respond to the Public Consultation on measures to ensure transparency and integrity of wholesale markets in electricity and gas.

The ECT-Group consists of entities active in the energy trading sector; several of them pursue also banking activities or render financial services related to energy derivative products. Entities which pursue banking activities or render financial services related to commodity derivatives are according to the German Banking Act investment firms which have to apply for a license in order to carry out the banking activities or financial services related to commodity derivatives and which are supervised by the German Financial Supervisory Authority Bundesanstalt für Finanzdienstleistungsaufsicht ("BaFin"). The ECT-Group serves as a platform for such firms in order to develop common positions with respect to the financial supervision and to communicate them to BaFin and other legislative and administrative bodies. There has been a steady and successful cooperation between BaFin and the ECT-Group in order to develop an adequate supervisory regime for investment firms rendering financial services related to energy derivative products.

II. Statement

The ECT-Group supports the efforts of the European Commission (EC) and of the Committee of European Securities Regulators (CERG) to categorise clients more individually and properly in the future based on their expertise, experience and knowledge by amending Annex II of MiFID.

We also share the opinion that client categorisation must be shaped in such way that the clients receive exactly the protection they need. As energy trading firms we will focus in our response on the practical consequences and needs of the markets for energy (electricity, gas, oil, transport capacity rights and emission allowances) and on the relevant energy derivatives. Since the majority of the ECT-Group members are, for the most part, not affected by the technical rules in question, we have confined ourselves to giving a response only to question no. 8.

III. Response to question 8: Do you believe that the client categorisation rules need to be changed in relation to OTC derivatives and other complex products?

Yes, the ECT-Group believes that the client categorisation rules in relation to OTC derivatives need to be adjusted; our remarks, however, are limited to commodity derivatives. One of the biggest risks the commodity markets have to manage is the risk of price change. Therefore, in the context of price hedging derivatives are of great practical significance for commodity traders.

Thus, we welcome the fact that CESR acknowledges that some clients do need to use potentially complex OTC derivatives in order to hedge precisely the specific and bespoke financial risks they may otherwise face. This also means, though, that these clients must have the possibility to carry out this risk management activity without having to face disproportionate barriers. However, especially small market participants have had the painful experience that rules adopted to protect them, in practice, turn out to be opposed to them and the desired protection is suddenly reversed.

Some (large) market participants have declared that they would only trade with professional clients. Small commodity traders, however, do not comply with the requirements of the per se professionals so that they must have the possibility to categorise themselves as professionals. In practice, though, it was often not possible for the affected traders, despite their long experience and their comprehensive expertise, to fulfil the criteria laid down in Annex II.II.1 of MiFID.

For this reason, the three criteria are too inflexible and impede that the level of protection provided satisfies the protection needs. In relation to commodity derivatives, the need of many traders for protection is very low since they can exactly assess the risk of energy derivatives, which is part of their core business. Firstly, in the commodity sector it often depends on details of the contract drafting (for instance: the possibility of the financial performance of contract) or the marketplace, whether it is a commodity or already a commodity derivative (and as a result a financial instrument). Secondly, these traders often

have a certain experience with commodity derivatives. But they are exempted from financial market supervision as they mostly trade in the underlying commodities and derivatives trading forms just a small part of their activity (they are thus exempted in terms of Art. 2 para. 1 i MiFID).

The three criteria of Annex II.II.1 are not suitable for this special situation; one can easily note that they are rather tailored to the classical financial markets and to wealthy individuals. In order to prevent the above described negative consequences for commodity and commodity derivatives dealers, we propose that the following amendment to Annex II section II.1 is considered:

- „Irrespective of these criteria, with regard to commodity derivatives and derivatives contracts included in Annex I, section C 10, a person shall be deemed capable of making his own investment decisions and understanding the risk involved, provided that his main business is related to the respective underlyings.“

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