

CESR Level 2 Consultation: Response by EFET

Introduction

The European Federation of Energy Traders ("EFET") represents more than sixty energy trading companies from 14 European countries. EFET was established in 1999 to stimulate and promote energy trading throughout Europe. Our members include the leading energy market participants that buy and sell energy commodities and derivatives over-the-counter and through exchanges: producers, suppliers, multi-utilities, large energy users, commodity houses and financial institutions.

The approach of any particular EFET member to energy trading varies with respect to its size, range and scope of products, the firm's know-how, resources and commercial requirements. While most of our members engage in physically settled gas and power transactions on the continent, an increasing number also trade financially settled commodity derivatives.

Overview

EFET welcomes the opportunity to comment upon CESR's Additional Level 2 Implementing Measures. We are aware of the extension of the new Market Abuse and Insider Dealing Directive (the 'Directive') to cover the business and operations of a commodity firm. Therefore we would like to point out that commodity markets are fundamentally different from the traditional financial markets that this Directive seeks to cover. EFET recognises and appreciates CESR intent not to implement the rules applicable for securities market to commodities markets and welcomes CESR's proposed Level 2 implementing measures. Nevertheless there remain some areas of concern, particularly in relation to the onerous and highly burdensome proposed rules for the establishment of insider lists and the disclosure of suspicious transactions. The concerns are detailed below in our responses to the questions posed by CESR.

Guidelines for Determining Accepted Market Practices

Question 1: Is the proposed approach appropriate, focussing both on the characteristics of particular market practices and the procedures that Competent Authorities should follow?

EFET agrees with the approach proposed by CESR. We believe that it is flexible enough not to hamper market innovation and wide enough to allow the Competent Authority to take an open and constructive approach to dialogue with market participants regarding such innovations.

Question 2: Are the suggested principles, factors and procedures appropriate? Would you consider adding more factors such as the degree to which a practice has a significant effect on prices and in particular on reference prices?

Whilst we broadly support the principles, factors and procedures defined, there are, we feel, a number of areas that need refining:

Paragraph 35, second bullet point – CESR should recognise that a significant proportion of commodity trading occurs in the over the counter (OTC) bilaterally negotiated markets. Trading can be for commercial and risk management purposes, as well as speculative reasons. The transactions undertaken in these markets would fall foul of this test and thus leave a large number of firms guilty of market abuse and prohibit them from undertaking useful risk mitigating activities.

Paragraph 35, sixth bullet point – CESR must recognise that there is no direct retail involvement in commodity and commodity derivatives markets. Drafting amendments need to be made to reflect this.

Paragraph 35, seventh bullet point – CESR and the Competent Authorities need to recognise the natural concentrations /large positions that often arise out of the physical need for/physical production of a commodity. Participants with large physical positions will need to hedge these in the financial markets. Such a large degree of hedging may impact liquidity. However, this commercial reasoning should be recognised as a defence against market abuse challenges.

Question 4: Do you agree that a practice need not be identifiable as already having been explicitly accepted by a competent authority before it can be undertaken?

Yes, EFET supports the view taken by CESR here.

Definition of ‘Inside Information’ for Derivatives on Commodities Markets

Question 6: Has CESR correctly identified all the relevant and material market, product and information factors relevant to the definition of ‘inside information’ for commodity derivatives?

We welcome the approach and are grateful for CESR’s recognition that imposing a system that is applicable to securities on to the commodities markets would not be suitable or workable.

Question 7: Is there further information which is material, relevant and disclosable in relation to commodity derivatives markets?

We believe not.

Questions 8: Does the draft advise accurately reflect the information relating to underlying commodities which commodity derivatives markets users expect to receive?

We believe that the drafting reflects this very well.

Insiders’ Lists

Question 10: Do you agree on the relevance of establishing a list for each matter or event when it becomes inside information? AND

Question 13: To what extent is drawing up a list of ‘permanent insiders’ useful? Should Level 2 identify the jobs which typically provide access to inside information?

It is EFET’s opinion that due to the nature of the commodities markets (and the energy markets in particular) it will be very onerous and time intensive if the relevant company is obligated to establish a list for each matter or event when it becomes inside information.

Therefore we propose that only a “permanent” list should be drafted. This permanent list would name all people with potential access to insider information. Such a list can be more easily maintained and updated. It can furthermore be granted that all people having potential access to inside information are captured whilst the lists for each and every matter contain the danger that some people might be overseen or simply forgotten.

Where member states Competent Authorities may already be satisfied that they collect such information or readily obtain such information from other regulatory authorities, no new lists may be necessary.

Question 12: Should Level 2 give examples of those persons acting on behalf of or for the account of the issuer who should be required to draw up lists?

EFET is of the opinion that CESR’s advice should not give examples of those people acting on behalf of or for the account of the issuer. It should be left to market practice who will have access to sensitive information and who will not. There might be situations where e.g. a legal advisor has deep insight in the relevant areas of a company but in another company the same position only grants limited access to the areas that are sensitive for the market.

Question 15: Would it be useful to describe the meaning of the expression ‘working for them’ (article 6, paragraph 3) for example, to give clarification regarding people who are not employees of the issuer?

Such expansion and clarification would be welcomed. Clarification should also be provided of the decision-making cut off level/knowledge level (i.e. attempt to create a materiality threshold) that would lead to inclusion on any list.

Question 16: Do you agree with the approach adopted regarding the criteria, which trigger the duty to update insiders’ lists?

Whilst we support the need for regular or timely updates, continuous updates would be burdensome. Therefore EFET have concerns regarding the frequency of updates as opposed to the requirement to update.

Disclosure of Transactions

Question 17: Is the above description for ‘persons discharging managerial responsibilities within an issuer’ sufficient for Level 2 legislation? Are there other persons that should be considered as belonging to the management of the issuer or should there be a specific restriction to persons who can assess the economic and financial situation of the company?

The expression “Persons discharging managerial responsibilities within an issuer” should only refer to those person who are officially charged with those responsibilities, being evidenced by the entry of the position in the business processes / organisational charts. Thus it

should exclude those positions which only refer to responsibilities within a restricted area of the company without having influence on the economic and financial situation of the company.

Question 18: Is the above description sufficient for Level 2 legislation? Are there other persons that should be considered as belonging to this category?

The description of “person who are closely associated” is not sufficiently described. This term should not only refer to person who are living in the same household – there may be persons living in the same property who are only sharing flats but have no close relationship to each other apart from sharing the costs for housing facilities. These persons should not be included in the description of persons living in the same household.

Therefore EFET proposes that the term “person who are closely associated” should only relate to person living in the same household and being an immediate family member.

Suspicious Transactions

Question 21: Do you agree with the proposed approach?

We are concerned about the approach proposed here and do not think it will prove workable. The second bullet point of paragraph 94 emphasises an individual’s obligation to report, rather than a company obligation. It would also suggest that some form of due diligence would need to be performed by the individual to determine whether a transaction is suspicious, but it is hard to envisage how this could happen without the presence of any evidence. This is a burdensome approach for individuals, and will likely result in a lack of reports being made (due to the information needed to review on a case by case basis).

We would rather see that either the wording contained in the Directive, namely ‘reasonably suspects’ (being a term that is well understood) be given its plain and ordinary meaning which would exclude the need for consideration of any factors or diagnostic flags, or that there is an express requirement to have considered facts and performed some form of due diligence prior to making the report. The requirements as they are currently drafted are unclear.

Question 23: Do you think that other elements should be mentioned?

No, we do not think that any other elements should be included. However, we would raise an issue concerning the requirement to report transactions that occur outside of a regulated market. There would also need to be a clear linkage, should any such reports be made to the Competent Authority, that the activities on the un-regulated market would have a direct and known impact on the regulated market that calls for action by the Competent Authority. This would assume knowledge of future events.

Question 24: Do you think that the proposed advice is appropriate?

Aside from the comments made above we feel that the advice fails to cover three key issues. Firstly, before any report is made a firm would need to consider the impact of the report being made on other legislative or regulatory requirements (for example the reporting requirements under anti money laundering regimes). Secondly, CESR should call for measures to be put in

place that would prevent the persecution of an individual by their employer for disclosing a transaction on a valuable client. Finally, we believe that the issue of false and malicious reporting needs to be addressed to prevent this happening.