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Committee of European Securities Regulators
Mr. Fabrice Demarigny
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MW/BW

CESR Work Programme on MiFID level 3 Work - Public Consultation

Dear Mr. Demarigny,

we welcome the opportunity to comment on the CESR Work Programme on MiFID level 3 Work (Ref. CESR/06-413).

The German Electricity Association (VDEW, Verband der Elektrizitätswirtschaft) represents more than 750 utilities (including most energy trading companies) covering more than 90 per cent of the German electricity market.

VDEW supports that CESR is starting to prepare ground for a consistent and convergent application of the new regime on financial instruments in the day-to-day practice of the provisions across all Member States.

Financial services regulation and the energy sector

Since the beginning of the liberalisation process in 1998, the European power market has evolved at a rapid pace; the development of market places for trading in energy products has become a major cornerstone for the purchasing and selling strategies of energy companies. Energy wholesale trading has emerged as a new business area that offers the urgently needed products and mechanisms to manage the risks that coincide with competitive markets. With the maturing of these markets they evolve more and more to European markets where it is essential to transact on a pan-European level without legal impediment.

With the progressing implementation of the Financial Services Action Plan (FSAP), respective regulatory provisions are coming into force that will also affect the energy industry. These are predominantly the Markets

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in Financial Instruments Directive (MiFID - 2004/39/EC), the closely linked Capital Requirements Directive (CRD - 93/6/EC) and the Market Abuse Directive (MAD - 2003/6/EC).

The extension of the scope of the MiFID to commodity derivatives and therefore also to energy derivatives has not only a significant impact on the financial community, but also on companies that are active in energy trading and will hence affect the further development of European power and gas markets. Without a careful consideration and implementation of respective regulations, particularly small and medium-sized energy companies may face considerable difficulties to comply with the provisions.

We like to point out that the aim of the deregulation of energy markets is to create a fully operational and competitive European market for electricity and gas. Hence the respective regulations shall guarantee an efficient, non-discriminatory and fairly priced network access, security of supply, efficient operation of power generation plants, transparency, access to storage capacities, interoperability between systems and a similar degree of market opening between Member States. This regime shall also ensure that end-customers have the choice to decide on their supplier based on comparable, transparent and reasonable energy prices. The development of a truly robust and liquid wholesale trading market for electricity and gas is a prerequisite to meet these aims. This wholesale trading takes place between professionals without participation of private retail clients (thus triggering less protection measures).

Convergence of EU supervisory - Convergent implementation and application of the MiFID

We particularly welcome that CESR is committed to ensure that financial supervisors apply a common approach to the operation of the Directive throughout the EU. This is an important step to achieve an integrated European capital and financial services market.

We support an appropriate body of rules and regulations to harmonise the European financial markets as it will create consistent conditions for market access, foster investor protection and, finally, strengthen the confidence in the markets and promote market liquidity. We also believe that the national implementation process of European Directives such as the MiFID should be as harmonised as possible; particularly, as the aim of the Directive (besides investor protection) is the harmonisation of the regulatory framework of the European financial markets in order to create a level-playing field for all market participants. A significantly different national implementation of the guidelines as set out in the Directive

would lead to distortions of competition throughout the Member States and devalue the European passport.

Efforts should also be made to ensure that the concepts used in financial legislation are compatible and harmonised as much as possible with other specific concepts outside the financial services, which, however, may also be affected (i.e. the legislation relevant for the internal energy market). For the energy industry (i.e. undertakings that are active in the European energy commodity or energy commodity derivatives markets), currently the 'legal picture' emerges in such a way that there is a whole set of regulations at European and national level creating a rather complex regulatory structure: First, the business activities are subject to the set of financial market legislation (MiFID, CRD, MAD); second it is also governed by the Internal Market Directives for Electricity and Natural Gas and, finally, it also has to comply with a set of further regulatory requirements including environmental and insolvency laws. For the latter, Member States seem to apply different rules on issues such as the enforceability of "close-out netting" with respect to physically trading commodities or the protection against the challenge by a liquidator of providing collateral for trading positions between entities which do not fall under the scope of their national banking or insurance supervisory regulations.

In this context, we also support the debate on the further convergence of the EU supervisory, as it will ensure a systematic and harmonised implementation and consistent application of EU rules. As already outlined above, we feel that otherwise it would create unequal conditions for the affected companies across the Member States. A consistent interpretation of Community law is a necessary prerequisite to create a level playing field and ensures that legal uncertainties and ambiguities are minimised. We generally encourage an implementation procedure of directives and regulations into national law that does not exceed the minimum requirements as set out in the respective provisions.

Let us comment on certain specific issues of the proposed CESR Work Programme on MiFID level 3 Work as follows:

I-Work in connection with upcoming Commissions's Reports

Currently, article 2.1 of the MiFID provides specific exemptions for commodity firms whose main business is dealing on own account in commodity derivatives (article 2(1)(k)) as well as commodity firms that provide investment services in commodity derivatives as an ancillary service (article 2(1)(i)). These exemptions are to be reviewed under

article 65 of the MiFID in 2007, which CESR has included in its work programme.

In this context we like to point out that the implementation of the MiFID (and hence the above mentioned exemptions) has by far not been completed in all jurisdictions. There are concerns that these specific exemptions for specialised commodity firms are not transposed into national law in the same manner or even at all across all Member States. This would mean that market participants will face different legal regimes and supervision in different Member States (i.e. needing a banking licence in one country but not in another), although conducting the same business activities. This does not only work against the idea to form a level-playing field but would also create a residual legal basic risk and would consequently negatively affect the further development of a pan-European power and gas wholesale market.

We also like to stress that these exemptions are specifically aimed to address the fact that the financial markets are significantly differently structured to the commodities market and particular the energy markets. Financial market regulations predominantly address market and credit risks as well as the operational risks of the traditional financial services market, without giving adequate consideration to the features of the commodity trading business and energy markets. While for the financial markets the flow of capital is predominant, the main area of business in European energy markets is the production and supply of energy. The wholesale nature of commodity and commodity derivative markets means that the regulatory risks presented by such markets (security of supply and price to end users) are significantly different to those presented by financial markets (systemic risk and investor protection).

The continuation of these exemptions are very important for energy trading businesses as energy firms that fall under the specific commodity dealers exemptions of the MiFID in turn are also exempted from the application of rules in the CRD. Without rules that take the peculiarities of the energy markets into account, an unadjusted implementation of the existing capital framework may hamper the Commission's objective to develop liberalised and functioning energy markets.

In this context, we also like to point out that close co-operation between CESR and the Committee of European Banking Supervisors (CEBS) is necessary as the review under article 65 of the MiFID regarding the above mentioned exemptions and the review under article 48 of the CRD (appropriate prudential regime for specific commodity firms) are very closely inter-linked; this is also reflected in the Commission's intention to produce one common report regarding both issues.

II-Work in connection with other Level 3 Committees (3L3)

In this context we particularly like to point out that there are significant interactions between the MiFID and the CRD (and also other Directives). As pointed out by CESR, the Committee of European Banking Supervisors has already started at the request of the Commission the consultation work on the review of capital requirements for commodity firms as required under article 48(2) of CRD. This work is key as it deals with the question of an appropriate prudential regime for certain firms carrying out business in relation to commodities derivatives and certain other derivatives contracts. As the number of commodity firms that have to comply with the MiFID regulatory regime may increase, these companies also need to comply with the respective capital adequacy rules set in the CRD. Here it is important to recognise that the financial markets are structured in a significantly different way in comparison with the commodities market and particular the energy markets.

III-Other Areas of Work

Regarding the list of financial instruments (section C of annex I of the MiFID), CESR suggests the clarifications on aspects of commodity derivatives (practical test).

In this regard, we like to point out that there are numerous European directives and regulations for financial services where we see the potential for further harmonisation regarding such 'simple' issues as applying the same definitions consistently across the various directives (one such example is the differing use of the concept of financial instruments in e.g. MiFID, CRD and MAD).

Final remark

We generally welcome CESR's approach to consult on its draft work programme for MiFID level 3 work at an early stage and fully support the aim to ensure convergence amongst supervisors. We share the view that a consistent and harmonised application of the rules are the key to create a level-playing field.

We also believe that there needs to remain a sufficiently high degree of flexibility in order to ensure that the diversity of existing markets and products as well as potential innovations are not being constrained. To avoid a disturbance in the further development of the European energy markets - a prerequisite for the competitiveness of the European union

as set out in the “Lisbon Strategy” - it is important to recognise the peculiarities of the energy market and take them into account when implementing and applying financial regulations.

We hope that our comments are helpful for the CESR’s work programme and would be glad to provide further input for CESR’s work. For any further questions, please do not hesitate to contact Dr. Bernhard Walter (bernhard_walter@vdew.net; phone +49/ 30 726 147 - 470) or myself.

Yours sincerely



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