CESR/08-755

CEBS 2008 154

15 October 2008

Feedback statement on CESR/CEBS's Consultation Paper on technical advice to the European Commission on the review of commodities business

(CP 3L3 08 02)

1. On 15 May 2008 the Committee of European Securities Regulators (CESR) and the Committee of European Banking Supervisors (CEBS) published a Consultation Paper on their technical advice on the review of commodities business (CP 3L3 08 02) [1].

2. The consultation period ended on 1 August 2008. CESR and CEBS received 16 responses, mostly from trade associations. Three respondents have requested confidential treatment, the other 13 responses have been published on the CESR and CEBS websites[2].

3. This paper presents a summary of the key points arising from the consultation and a feedback table which reflects CESR/CEBS's detailed views on the public responses. CESR/CEBS's responses to the comments received should be read in connection with CESR/CEBS's advice to the European Commission.

   http://www.cesr.eu/index.php?docid=5306

General comments

4. The respondents highly appreciated the early and on-going involvement of the industry in the development of CESR/CEBS's technical advice on commodities.

---

[1] http://www.cesr.eu/index.php?page=consultation_details&id=111 and http://www.c-ebs.org/Publications/Consultation-Papers/3L3-Cross-sectoral/CP-3L3-08-02.aspx

[2] http://www.cesr.eu/index.php?page=responses&id=111 and http://www.c-ebs.org/getdoc/c0020822-c776-4a6d-974b-69a3e65d0052/Responses-to-CP-3L3-08-02.aspx

5. A few common general features of the responses are worth highlighting. Most notably, there was a general trend to distinguish between *commodity derivatives markets* and other financial markets, and flowing from this the risks posed to both the financial system and to clients by physical players from the risks traditionally associated with financial services firms. These respondents also emphasized the differences between different *commodity derivatives markets*. It was stressed that existing sectoral regulation of physical *commodity markets*, e.g. for electricity and gas, should be taken into account when considering financial market regulation. No additional burdens should be introduced. In this context it was also pointed out that, in particular, the provisions of the Capital Requirements Directive (*CRD*) have been designed for credit institutions and are not appropriate for *specialist commodity derivatives firms*.

6. Their assertion with regard to systemic risk was based on the fact that these firms largely participate in financial markets to hedge commercial business, which notably is assets-based, and that the inter-linkages between *specialist commodity derivatives firms* and traditional financial firms are limited. Their view that *commodity derivatives markets* pose less risk to clients was based on the assertion that there are few unsophisticated clients participating directly in *commodity derivatives markets*.

7. Another general theme running through the responses was related to the complexion of the participants in these markets. Respondents said that due to the complexion of participants and the different characteristics of various *commodity derivatives markets*, it was important to not only take a proportionate approach to the application of requirements, but it was equally important that the interpretation and application of these requirements should be uniform throughout the EU. This was considered particularly important in view of the international nature of *commodity derivatives* business. This was mainly related to the application of *MiFID* requirements, although some respondents extended the point to cover financial markets regulation more generally.

CESR / CEBS's response:

CESR/CEBS acknowledge that there are differences between *commodity derivatives markets* and other financial markets, and between different *commodity derivatives markets*. These differences have been taken into consideration where appropriate in the light of the outcome of the market and regulatory failure analysis and in the final recommendations.

Annex

Feedback table on CP 3L3 08 02: analysis of the public responses and suggested amendments

CP 3L3 08 02, Question:	Summary of comments received	CESR/CEBS's response
1. In practice what proportion and/or amount of *OTC commodity derivative* transactions are financial instruments falling within *MiFID* and what proportion is spot? (A differentiation in relation to the underlying would be helpful)	There were two substantive responses to this question. One respondent commented that the majority or a significant number of *OTC* trades were within *MiFID's* scope, including forward *energy* contracts. The other respondent said that the majority of *OTC* electricity and gas contracts, in particular, fell outside the Directive. Respondents were not able to provide figures indicating what proportion of *OTC commodity derivative* transactions are financial instruments falling within *MiFID*.	There are insufficient grounds to suggest that the large proportion of *OTC* trading in *commodities derivatives markets* is hampering the aims of market or prudential regulation, or more specifically giving rise to market failure. Issues concerning gas and electricity trading will be addressed by CESR/ERGEG in their forthcoming advice.
2. Do you agree that the level of direct participation by unsophisticated investors is mainly limited to corporate clients such as producers or wholesale distributors (with a lack of experience and knowledge in derivatives markets but not in trading in physical *commodity markets*),	Five of the responses broadly agreed with the statement in the question. Three of the respondents said that in their areas of the market direct participation by individuals was virtually non-existent. One respondent said that many corporate clients have increased their knowledge of derivatives markets and are not unsophisticated participants. One respondent said that private client participation was 'relatively low' rather than 'very low' because	The boundary lines for professional clients established by *MiFID* may not adequately reflect the client characteristics in *commodity derivatives markets*. Whilst there is no evidence of a need to change conduct of business rules for *commodity derivatives* business, CESR/CEBS believe that a similar transitional provision to that in Article 71(6) of

that participation by private clients is very low, and that most other participants in *commodity derivatives markets* are sophisticated firms?	unsophisticated participants were expanding their direct and indirect exposure to *commodity derivatives*.	*MiFID* regarding professional clients would be appropriate if additional firms were to be brought within the scope of *MiFID* as a result of any changes to the *MiFID* exemptions.
3. What informational advantages persist in *commodity derivatives markets* and in particular to what extent do those also active in the underlying physical market have informational advantages?	The respondents to the Consultation Paper expressed some concern about information asymmetries linked to data about developments in physical *commodity markets* such as, for example, outages at power plants. One respondent said that early knowledge of information that could affect the physical market is a major advantage and may lead to attempts to corner or squeeze the market. However, another respondent said that there are many sources of information that are commercially available to market participants and that the sophistication of most market participants means that they were well able to take into account possible information asymmetries.	Generally CESR/CEBS believe that the potential for market failures due to information asymmetries is limited in *commodity derivatives markets* given the experience and knowledge of current participants (see also question 4). CESR/CEBS's advice to the Commission however points out that some market participants may have informational advantages when they are active in the *commodity derivatives markets* and *commodity* production or supply at the same time. Please see Part B, Market Failure Analysis.
4. Do information asymmetries in commodity derivatives markets lead to mis-selling concerns, or other concerns about potential client detriment?	Most respondents stated that there are no mis-selling concerns due to asymmetric information. This is due to the fact that market participants are predominantly sophisticated investors or professional clients. One respondent representing firms other than *specialist commodity derivatives firms* said that information asymmetries linked to developments in the physical markets could put the clients of their members at a disadvantage relative to market participants active in that market.	The majority of participants in *commodity derivatives markets* are *sophisticated* and have the knowledge and experience to make their own investment decisions. Therefore the advice to the Commission states that outside of the limited direct participation in *commodity markets* by private clients the potential for significant market failures due to information

		asymmetries is limited. Please see Part B, Market Failure Analysis.
5. Do you have any transparency-related concerns relating to the trading of non-electricity and gas *derivatives*? If so, in which markets and why?	The majority of respondents -although not all- stated that there are no transparency concerns with respect to non-electricity and gas derivatives. Two respondents again raised the issue of transparency on the physical market. One of these respondents however thought that there are no particular concerns arising from the current levels of transparency. Please see question 11 below.	CESR/CEBS's advice states that the significance of *OTC commodity derivatives markets*, combined with lower associated market transparency, raises potential concerns about information asymmetries. However, regulated trading firms have not voiced this as a major concern which deters them from participating in the markets. This has been confirmed by the responses to the consultation. Overall, therefore CESR/CEBS do not recommend additional legislative action in this regard.[3] Please see Part B, Market Failure Analysis and Part D, *MiFID* questions 4 and 6.
6. Do you have evidence of informational asymmetries in *commodity derivatives markets*	Most of the respondents said they do not have evidence for market abuse due to informational asymmetries. However, one respondent referred to efforts to corner or squeeze markets citing wheat trading on the Minneapolis	*Commodity derivatives markets*, like other financial markets, are subject to informational asymmetries which can give rise to abusive market conduct.

[3] The Autorité des Marchés Financiers (AMF) does not share this view and believes that increased post- trade transparency of *OTC* commodities derivatives trading, properly calibrated, would be likely to bring net economic benefits to the market. Such objective could be reached either through regulatory intervention or through an industry-led initiative within a framework defined by regulators.

in relation to market abuse?	Grain Exchange in the first quarter of 2008 as an example of this and two respondents mentioned an attempt to carry out a squeeze on LME Nickel contracts in 2007. Some respondents to the Consultation Paper pointed out that *commodity derivatives* are already within the scope of the Market Abuse Directive.	CESR/CEBS's advice to the Commission states that issues related to market abuse should be addressed in the Commission's wider review of the Market Abuse Directive. Please see Part B, Market Failure Analysis and Part D, *MiFID* questions 4 and 6.
7. Please provide any information you may have on the levels of lending and trading exposures between *specialist commodity derivative firms* and *institutions.*	There were five responses to this question including one joint response from three trade bodies. Although most stated they had little or no data, all but one commented that inter-connections were limited and agreed with the earlier Task-Force conclusion that the systemic risk of specialist commodities derivatives firms (SCDFs) was low. One respondent commented that the extent of inter-connections was increasing following the rising participation of financial institutions in *energy* derivatives markets. However, this respondent also stated that the use of exchanges and master agreements as well as cleared bilateral contracts greatly reduced the risk posed by SCDFs to financial institutions.	This is consistent with the view outlined in the Consultation Paper.
8. What level of risk do you consider *specialist commodity derivative firms* pose to the financial system?	CESR/CEBS received eight responses to this question, all of which agreed that the level of risk posed by SCDFs to the wider financial system was very limited. Respondents gave a range of reasons for reaching this conclusion: that the firms themselves are small, are asset-based businesses, are almost exclusively involved in price risk hedging, have few or no retail clients and that failures of such firms have not so far caused systemic problems. One respondent also commented that the main business of these firms was the underlying *commodity* and therefore their systemic impact on the financial markets was very limited.	This is consistent with the view outlined in the Consultation Paper. However, after the consultation some CESR/CEBS members raised concerns about this conclusion and its wider consequences. Therefore, the final advice refers to different opinions in this regard. Please see Part B, Market Failure Analysis and Part C, Regulatory Failure Analysis.

9. To what extent does the level of systemic financial risk posed by *specialist commodity derivative firms* differ from that generated by banks and *ISD* investment firms?	In accordance with responses to the two previous questions, the nine respondents who addressed this question all agreed that *specialist commodity derivatives firms* pose much lower systemic risk than that of either banks or *ISD investment firms*. The reasons cited were the same as in question 8.	This is consistent with the view outlined in the Consultation Paper. However, after the consultation some CESR/CEBS members raised concerns about this conclusion and its wider consequences. Therefore, the final advice refers to different opinions in this regard. Please see Part B. Market Failure Analysis and Part C. Regulatory Failure Analysis.
10. Do the risks generated by energy-only investment firms differ materially from those posed by investment firms engaging in other commodity derivative activities/services? If so, how do they differ?	There were five responses to this question all agreeing that the difference was either non-existent or negligible.	CESR/CEBS agree. Please see Part E, *CRD/MiFID* question 5.
11. Do you have any transparency-related concerns relating to the trading of non-*energy commodity derivatives*, and, if so, in which markets, what are the concerns, and what solutions could be applied?	One respondent argued for regular publication of core data from the underlying physical markets and price and volume data on executed *OTC commodity derivatives* trades. One respondent indicated that *MTFs* should be subject to the same transparency regulation as regulated markets. The others did not in general see a need for further regulation of *commodity derivatives markets* to improve transparency. One respondent believed that revealing of trades might be an advantage of largest and widest-established market participants. Another respondent saw rules for best execution as less relevant as clients were experienced.	CESR/CEBS note in their advice that the significance of *OTC commodity derivatives markets*, combined with lower associated market transparency, raises potential concerns about information asymmetries. However, in practice regulated trading firms have not voiced this as a major concern which deters them from participating in the markets. Overall therefore CESR/CEBS do not believe that there is much benefit to be gained by mandating through legislation greater pre- and post-trade transparency in *commodity derivatives markets*. As noted previously the Autorité des

		Marchés Financiers (AMF) does not share this view and believes that increased post- trade transparency of *OTC* commodity derivatives trading, properly calibrated, would be likely to bring net economic benefits to the market. In its opinion, such objective could be reached either through regulatory intervention or through an industry-led initiative within a framework defined by regulators. Please see Part D, *MiFID* questions 4 and 6.
12. Do you believe that for non-electricity and gas *derivatives* contracts, the transaction reporting requirements in the *MiFID* support market regulation? If so, can you explain why you think they do?	Two respondents believed position reporting was more appropriate than transaction reporting for the *commodity derivatives markets*. One other respondent believed transaction reporting would ensure adherence to market regulation. Another respondent believed that transaction reporting would deter firms from freely hedging risk.	There are questions as to the relevance of transaction reporting requirements in Article 25 (3) of *MiFID* for the fulfilment of the competent authorities' tasks in upholding market integrity in *commodity derivatives markets*. However, CESR/CEBS consider that current arrangements where regulated markets provide transaction reports in relation to *commodity derivatives* to their home Member State competent authorities continue to provide a satisfactory solution. Please see Part D, *MiFID* questions 4 and 6.
13. Do you have any evidence of potential problems, and if so, on the scale of these problems, that are posed by current client categorisation	Seven respondents believed that the categorisation of professional clients should be extended to cover *sophisticated* clients in the *commodity derivatives markets*. One respondent did not see the question as relevant for them.	The final CESR/CEBS advice outlines, that the client categorisation rules should be amended. Please see Part D, *MiFID* questions 4

rules?		and 6.
14. Do you have any evidence that regulation according to the main business of the group may cause competitive distortions?	None of the respondents to this question had evidence on whether competitive distortions exist but differed in their opinions. Four respondents added that equal treatment of all market participants may give rise to competitive distortions.	CESR/CEBS's final advice suggests that basing some of the exemptions on the main business of the group may cause a competitive distortion but notes that respondents to the Consultation Paper could see little evidence of this in practice. Please see Part C, Regulatory Failure Analysis.
15. Do you agree that full application of *CRD* capital requirements to *specialist commodity derivative firms* is likely to impose a regulatory burden that is misaligned with their potential systemic impact?	Respondents agreed that the full application of the *CRD* would be excessive. One respondent argued that the tightening of the current regime would increase market access barriers. In general, most respondents stressed that the full application of *CRD* to *specialist commodity derivatives firms* would impose a restrictive and costly regulatory burden.	This is consistent with the view outlined in the Consultation Paper. However, after the consultation some CESR/CEBS members raised concerns about this conclusion and its wider consequences. Therefore, the final advice refers to different opinions in this regard. Please see Part F, *CRD* questions 4 and 6.
16. Do believe that full application of the *CRD* large exposure requirements to *specialist commodity derivative firms* is likely to impose a regulatory burden that is misaligned with their business and their potential systemic impact?	Respondents agreed that the full application of the *CRD* large exposures rules would be excessive. In agreeing, one respondent said it would be difficult to change commercial practice in *energy* markets which gives rise to exposures which under the large exposure regime would require additional capital. Another said that in the metals market firms deployed their own tools, such as multilateral netting agreements and ISDA master agreements, to reduce exposure and that the exposures of metals broker/dealers are far smaller than large corporate banks.	This is consistent with the view outlined in the Consultation Paper. However, after the consultation some CESR/CEBS members raised concerns about this conclusion and its wider consequences. Therefore, the final advice refers to different opinions in this regard. The issue of additional physical collateral is outside the scope of the

	One respondent thought that additional physical collateral other than commercial real estate should be eligible under the Large Exposures regime (to be included in amendments to the Large Exposures section of the *CRD*).	review of commodities business. Please see Part F, *CRD* questions 4 and 6.
17. Do you believe there is a potential for regulatory arbitrage? If so, can you provide evidence?	Several respondents agreed that there is potential for regulatory arbitrage, resulting either from "gold plating" by certain Member States or inconsistent application of the *MiFID* exemptions. A few respondents also mentioned the potential of regulatory arbitrage in favour of third countries. In certain cases however, it was pointed out that any regulatory arbitrage was impossible, for example through the combination of FSA rules and LME rules.	Harmonising the European regulatory framework, including through consistency of interpretation across Member States, is a key objective for CESR and CEBS.
18. Do you believe that the application of the *MiFID* organisational requirements support the intended aims of market regulation when applied to specialist *commodity derivatives* firms, or *commodity derivatives* business? If not, what aspects of the organisational requirements do you believe do not support the aims of market regulation when applied to such firms and why?	Some respondents thought that the *MiFID* organisational requirements, tempered by the proportionality principle, were suited to *specialist commodity derivatives firms*. Others thought that commodities firms, especially small ones, would have difficulty complying with certain requirements such as the segregation of functions or senior management possessing sufficient experience in both commodities and derivatives.	There does not appear to be a demonstrated need to amend the organisational requirements of *MiFID* for *specialist commodity derivatives firms*. These requirements apply to small investment firms already, taking into account the proportionality principle. Please see Part D. *MiFID* questions 4 and 6.
19. Do you believe that there is a case for changing the client categorisation regime as it applies to *commodity derivatives* business? If so, do you have any evidence on the scale of the problem, or	Several respondents replied that the *MiFID* client categorisation regime is poorly adapted to *commodity derivatives* business and that in some cases the problem is serious, since expert clients are unable to opt-up to professional status because of the rigid quantitative criteria, resulting in the exclusion of some *sophisticated* clients from the market. Respondents suggested various	CESR/CEBS agree that the current rules are too rigid and propose that a client should be able to opt-up where the firm believes, after an adequate assessment of the client's expertise, that the client is able to make its own investment decisions and manage the

potential problem posed by the existing rules?	remedies, including opt-up on request or automatic professional client status for those who need to hedge the related risk. One firm stated that 10% of its clients had been grandfathered into professional client status but would not be able to meet the new criteria, and suggested allowing opt-up after an assessment of the client's expertise.	risks involved in the relevant transactions. Please see Part D, *MiFID* questions 4 and 6.
20. Do you believe that the conduct of business rules in the MiFID effectively support the aims of regulation with respect to commodity derivatives business? If not, can you explain why and in what respects, and whether your response is contingent upon the client categorisation definitions applied to commodity derivatives business?	Very few respondents viewed the *MiFID* conduct of business rules as unsuitable for *commodity derivatives* business, although the point was made that many of the rules would not apply because the clients are *sophisticated*.	CESR/CEBS see no evidence of a need to amend the *MiFID* conduct of business rules for *specialist commodity derivatives firms*. In particular, the rules that apply to professional clients appear to be suited to *sophisticated* clients doing *commodity derivatives* business. *MiFID* also includes an even less prescriptive regime for certain services provided to eligible counterparties. Please see Part D, *MiFID* questions 4 and 6.
21. Do each of the following elements of the criteria for determining which commodity derivatives contracts are financial instruments offer sufficient clarity to market participants to understand where the boundaries of MiFID lie: **a) the phrase '...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**	Two of the respondents said that the criteria are reasonably clear. One other respondent said that there was no appetite for revisiting this aspect of *MiFID*. One respondent said that the criteria were generally clear but clarification would be helpful around the issue of when a contract is deemed to be equivalent to a contract traded on a regulated market or *MTF*. One respondent said that there was room for improving the clarity of several aspects of the criteria and, in particular, the scope of 'freight rates' in Section C (10) of Annex I to the *MiFID* could be clarified.	CESR/CEBS do not recommend any changes to the criteria that determine which *commodity derivatives* contracts are financial instruments within the scope of *MiFID*. According to the *MiFID* Implementing Regulation a contract will be equivalent to a contract traded on a regulated market, *MTF* or third country trading facility where it is 'expressly stated to be equivalent', is not a spot contract and meets the conditions in points (b) and (c) of

other termination event)'; **b) the phrase 'traded on a regulated market and/or MTF'** **c) the definition of a spot contract in Article 38(2) of the implementing regulation:** **d) the criteria in articles 38(1)(a),(b) and (c);** **e) the definition of a commodity in Article 2 of the implementing regulation; and** **f) the list of underlyings of exotic derivatives mentioned in Section C(10) of Annex I to MiFID and Article 39 of the implementing regulation.**	One respondent said that legal definitions should not inhibit access to liquidity provided by *MTFs*.	Article 38 (1) of the *MiFID* Implementing Regulation. This means either that it must be cleared or 'there are arrangements for the payment or provision of margin in relation to the contract', and that it is standardised. The reference to 'freight rates' seems to be relatively straightforward. It refers to derivatives the underlying of which is the cost of transportation. CESR/CEBS have no evidence that the definition of a financial instrument in *MiFID* is inhibiting access to liquidity provided by *MTFs*. Please see Part D, *MiFID* questions 4 and 6.
22. Do you have any evidence of physically-settled commodity OTC contracts being written in a way which deliberately takes them out of the definition of financial instruments?	Several respondents to the Consultation Paper said there was no evidence that physically-settled *commodity derivatives* contracts were being written in a way so as to deliberately avoid regulation. However, one respondent said that many companies had stopped using a regulated market which trades *commodity derivatives* contracts to get absolute certainty that they were outside regulation (albeit that they probably fell within one of the exemptions).	CESR/CEBS believe that there is no need to revise the definition of financial instruments in *MiFID* as it relates to *commodity* and *exotic derivatives*. The existing definition seems to provide an adequate degree of clarity. The use of 'expressly stated to be equivalent' does give some discretion to market participants to determine whether or not contracts are financial instruments. However, CESR/CEBS have only very limited evidence that this is leading to regulatory arbitrage. Please see Part D, *MiFID* questions 4

		and 6.
23. Do you believe there are sufficient similarities between different *commodity derivatives markets* to make it inappropriate to differentiate the regulatory regime on the basis of the underlying being traded?	Some respondents argued that the similarities between different *commodity derivatives markets* are more important than the differences, and that distinctions made between the regulatory regimes applying to different types of *commodity* or *exotic derivatives* would be artificial. Other respondents argued that a distinct approach was required for *energy* firms, because the key issues relating to *energy* are those of production and supply rather than the flow of capital, and because the use of derivatives markets is just one part of managing production and supply for these firms, which are very different from traditional financial services firms. Most respondents, however, were of the view that the similarities between the risks posed by *energy*-only firms and firms active in other *commodity markets* were greater than the differences.	CESR/CEBS do not believe that it is appropriate to differentiate the regulatory regime based on the underlying *commodity*, asset, right, service, or obligation. With regard to *energy* CESR/CEBS have not uncovered compelling evidence that suggests that the risks generated by *energy*-only investment firms differ materially from those posed by investment firms engaging in other *commodity derivative* activities/services. Of course, this conclusion does not cover the issues being dealt with in the CESR/ERGEG review, which will express a view on the desirability of a specific regime for *electricity and gas* derivatives. Please see Part E, *CRD/MiFID* question 5.
24. If the capital treatment of specialist commodity derivative firms is resolved, do you think there is still a case for retaining both of the exemptions in Articles 2(1)(i) and (k)? If not, how do you think the exemptions should be modified or eliminated? If the exemptions in Articles 2(1)(i) and (k) were eliminated, what	Five respondents said that they thought the exemptions should be retained as they were. They said they were important to ensuring that non-financial businesses were able to remain outside the scope of the Directive. Removal of the exemptions could damage the liquidity of markets such as the electricity wholesale market. One of these respondents said that the exemptions should be made mandatory across Member States. One respondent said that the exemptions should be replaced by a single exemption for firms whose main	CESR/CEBS's final advice to the Commission is that the exemptions should be revised rather than removed. We accept that there are many non-financial firms who use *commodity derivatives* who should remain outside the scope of regulation. However, the advice suggests that the exemptions should be revised to

effect do you think this would have on commodity derivatives markets?	business consists of dealing on own account in relation to commodities and/or *commodity derivatives*. Two of the respondents who favoured retention of the existing exemptions said they could support this proposal if the exemptions were to be modified. One respondent said that the exemptions should cover *commodity* firms who trade on own account or for parent undertakings, subsidiaries etc. They expressed concern that any revision of the exemptions might lead to some firms losing their ability to passport and suggested that firms covered by the exemptions should be able to opt in to being authorised under *MiFID*. One respondent said that exemptions can lead to distortions and said that, in general, they agreed with the suggestion in the CP that the exemptions could be revised to make them clearer. Two of the respondents expressed particular concern about the potential implications of abolishing the *MiFID* exemptions and the Article 48 exemption in *CAD*.	focus more clearly on the types of firms who should be exempted from financial services regulation. CESR/CEBS believe that the own-account dealing exemption proposed by one respondent is too wide and could well narrow the existing scope of regulation. The final advice proposes to consider clarifying in *MiFID* that firms who fall within the specific commodities exemptions should be able to opt to be authorised under the Directive. CESR/CEBS indicate in the advice that they do not necessarily believe that it is legally possible to harmonise the regulatory treatment of firms who are exempt from *MiFID*. CESR/CEBS accept that there is a linkage between the debate on the *MiFID* exemptions and the prudential treatment of *specialist commodity derivatives firms*. Please see Part D, *MiFID* questions 4 and 6.
25. Do you believe based on the above analysis that the application of the CRD large exposures regime to specialist commodity derivatives firms is disproportionate?	In general, most respondents believed that the large exposures regime is excessive. One respondent stressed the need to review concentration risk rules, if initial margin is included within the concentration risk calculation, based on the need to increase regulatory capital or to reduce credit lines to clients, but a full consultation process should be carried out in this regard.	This is consistent with the view outlined in the Consultation Paper. However, after the consultation some CESR/CEBS members raised concerns about this conclusion. Therefore, the final advice refers to different opinions

	One respondent argued that this review has the potential to result in regulation that may create large exposures, because large exposures can result from operations undertaken by trading entities on behalf of other group companies. This activity would grow as a result of applying a Pillar 1 minimum regulatory capital charge. Applying a Pillar 1 charge to a subset of the firms' activities will lead to the subsidiarisation of this business.	in this regard. Some CESR/CEBS members conclude that the application of the *CRD* large exposure regime to *specialist commodity derivatives firms* would be disproportionate. Other members however see no evidence that the application of the *CRD* large exposure regime would be disproportionate. Please see Part F, *CRD* questions 4 and 6.
26. Do you agree that the maturity ladder approach is unsuitable for calculating capital requirements for non-storable commodities? If yes, are the proposed alternatives better suited to that task?	All respondents that commented on this question agreed that the maturity ladder approach is unsuitable for non-storable commodities; most respondents identified applying spot prices to forward contracts as the main issue. Comments stressed that current spot prices, particularly for electricity and gas, do not reflect market expectations at a future delivery date. All respondents agreed that using forward prices instead of spot prices would be a good starting point. One respondent stressed that a full consultation process should be carried out for any alternatives. Some respondents argued that the maturity ladder approach could also be unsuitable for storable commodities. This was based on the observation of significant backwardation structures, where prices for short term products are much higher than for products at the long end of the price curve, meaning that spot prices can be less relevant. Apart from unsuitability of spot prices, more general reservations to the maturity ladder approach were raised; in particular, that it would be insufficiently granular with respect to different *commodity* types and that it would not capture specific features of the forward curve.	CESR/CEBS acknowledge that respondents have unanimously agreed that the maturity ladder approach is unsuitable for non-storable commodities, in particular because of using spot prices, and that this approach could also be unsuitable for storable commodities under certain circumstances. Since comments have identified applying spot prices to forward contracts as the most important weakness, CESR/CEBS take this as support for option 1, i.e. allowing the use of the current forward price instead of the spot price. With respect to the general reservations on the maturity ladder approach, CESR/CEBS do not see room for manoeuvre. Further amendments to take into account other peculiarities of commodities business, as suggested by individual

	Examples given referred to significant backwardation of the term structure of volatilities for power and gas, such that the 15% outright rate was deemed to be too low for short-term products and too high for long-tem products. The same respondent considered the 3% spread rate to be too high for the basis risk of commodities such as metals whose maturity buckets are correlated. One respondent suggested that for electricity a satisfactory approach would be not to offset the positions within a 10 day period but rather to calculate market values for long and for short positions on an hourly basis to enter into the ladder. With respect to the alternative approach outlined in option 2 and Annex I, one respondent agreed that this alternative approach could be appropriate to mitigate the problem of overestimating risks. This respondent especially emphasised that this approach does not solely depend on current forward prices but instead derives forward prices from the history over a specified observation period. However, other respondents expressed strong objections to this approach, since in their opinion it: (1) does not consider correlations within a market risk portfolio, (2) has a significant bias in comparison to a risk model which they consider to be adequate, (3) mingles two different approaches, since a maximum value is added which is not part of a VaR risk model, and (4) leads to significant costs for IT implementation when used in addition to a method considered by these respondents to be adequate for risk management.	respondents, could significantly change the substance of this approach and would therefore require drafting a completely new approach. CESR/CEBS have made a proposal for an approach in option 2 and Annex I. With respect to the criticism of the alternative approach as outlined in option 2 and Annex I, CESR/CEBS respond as follows: • Implicitly these respondents are saying that using an internal market risk model for calculating regulatory capital requirements is more suitable for better recognition of correlations and for risk management. CESR/CEBS believe that this could be the case and therefore are not recommending the historical forward price approach as a replacement for using own internal risk management models to calculate regulatory capital requirements (Annex V of *CAD*), but as an additional standardised approach which should be available as an alternative to the maturity ladder approach. • For the purpose of a standardised approach it is however not recommended that firms be allowed to use their own estimates of correlations between different delivery/settlement dates.

		Especially, since spot prices for certain commodities (electricity and gas, but also for some soft commodities) and for *exotic derivatives* (e.g. climate) have a more or less strong seasonal structure (e.g. spot prices for electricity could typically be higher in winter than in summer, higher during the week than on weekends, higher for peak hours than for off-peak hours, especially in the night). For such commodities, estimating correlations between different delivery/settlement periods requires a rather sophisticated reflection of the impacts of these seasonalities on dependencies between movements of prices for different delivery periods. Where an *institution* would like to estimate such correlations, it should apply to use an internal market risk management model to calculate regulatory capital requirements. • With respect to IT implementation costs, it should be noted that the historical forward price approach is still intended to be a standardised approach and as such avoids qualitative requirements comparable to using an internal market risk management model. Although higher implementation costs compared to the maturity

		ladder approach could occur, this approach still avoids the even higher implementation costs of complying with the qualitative requirements for using an internal market risk management model to calculate the regulatory capital requirements. • With respect to the criticism on mingling two different approaches, it should be noted that a standardised approach makes it necessary, from a prudential point of view, to include a sufficient degree of conservatism to ensure that potential losses are sufficiently covered by own funds. For this reason, the calculation of capital requirements has been based on the maximum accumulated change in market value of a market risk portfolio which has been observed for a certain trading day, plus a figure for the possible increase in such observed changes in market value of a market risk portfolio (based on a 99% confidence level and a holding period of 10 days and the assumption of normality for price returns). If an *institution* considers referring to the maximum observed change in market value to be inappropriate for internal risk management, it would still remain possible for it to take into account the results of the

		historical VaR calculation. Please see Part F, *CRD* questions 4 and 6.
27. Do you believe that the shortcomings identified in 2. b. and c. and 3. are relevant? Are there others that need consideration?	All respondents that commented on this question agreed that the identified shortcomings are relevant. One respondent considered the following to be further shortcomings: 1. Operational Risk Basic Indicator Approach should be based on three months' (instead of three years') relevant expenditure to reflect the nature of the risks of *commodity market* participants. 2. Because of the short-term nature of *CCR* exposures of *commodity* firms and the daily variation in the utilisation of credit by customers, *CCR* should be eligible to be covered by Tier 3 capital such as subordinated debt having a minimum initial maturity of 2 years. Moreover, subordinated debt should be eligible without limitation on its maturity, and the notice period should be reduced. 3. Where *commodity* firms' accounts are externally audited at the end of the year, interim profits should not need to be externally verified before they can be included in Core Tier one capital. The treatment should be the same as for material interim net losses which need to be included immediately without the need for external verification.	CESR/CEBS feel that the shortcomings identified have been confirmed. With respect to the further points considered by one respondent to be shortcomings, CESR/CEBS do not see room for manoeuvre. Please see Part F, *CRD* questions 4 and 6.
28. Do you think that the solutions outlined above are adequate to address these	Most respondents that commented on this question agreed that the solutions outlined are reasonable for addressing the identified problems.	CESR/CEBS feel confirmed in proposals 2.c and 3 for addressing identified shortcomings.

problems?	On 2.b, one respondent commented on reporting obligations for entities engaging in *commodity derivatives* activities as an ancillary business that the frequency of reporting requirements should be reduced to semi-annual and that the requirements should apply only to entities whose inventories exceed €1 million at market prices. Another respondent considered that the waiver of the mandatory disclosure of the corresponding inventories alone would not solve the problem, since for the purposes of the calculation of capital requirements credit *institution*s would still remain obliged to carry out inventories during the year. Instead this respondent suggested that banks keeping their exposure within reasonable bounds should be entirely exempt from compliance with the provisions on *commodity* risks. For this purpose, this respondent proposed a threshold of EUR 500,000 for the exposure value within the meaning of the simplified approach according to point 19 of Annex IV of Directive 2006/49/EC. On 3, one respondent commented that competent authorities must continue to be free to allocate resources to the approval process.	With respect to proposal 2.b, CESR/CEBS appreciated the comments from the industry and acknowledge that relaxation of reporting requirements alone would not solve the problem of burdensome inventories during the year. However, an approach for solving this problem should, in the view of CESR/CEBS, not contain a general exemption from capital requirements for these specific risks. CESR/CEBS consider that a simplified approach for reporting and calculation of capital requirements for ancillary agricultural commodities business could solve the problems mentioned above and still provide a meaningful prudential treatment for these risks. CESR/CEBS have included a concrete proposal for such an approach in the final advice. With respect to the comment on 3, CESR/CEBS refer to the fact that the Directive is silent on the model approval process, and competent authorities are therefore free to allocate resources to the approval process that are proportionate to the risk and size of the assessed firm. Please see Part F, *CRD* questions 4 and 6.
29. Do you agree with the	Respondents agreed that a general *commodity* regulatory	CESR/CEBS did not find compelling

conclusion above?	regime is appropriate, since differences between the risks connected with *energy* derivatives and the risks connected with other *commodity derivative* activities/services are considerably lower than the differences between the risks posed by *institution*s and the risks posed by *specialist commodity derivatives firms*. One respondent said there is no difference between *energy* firms and other *commodity* firms regarding systemic risk. For good liquidity management, small firms must have access to the market.	evidence that the risks generated by *energy*-only investment firms differ materially from those posed by investment firms engaging in other *commodity derivative* activities and services. CESR/CEBS believe that it is therefore doubtful that there should be a separate class of *energy* investment firm subject to a regime that differs from the wider *commodity* regulatory regime. Please see Part F, *CRD* questions 4 and 6.
30. Which of the options presented above do you consider appropriate for the application to specialist commodity derivative firms?	All respondents that expressed a view were in favour of Option 1 (one respondent was in favour of option 1 or 2). One respondent mentioned that in relation to option 4 more information about the scope of the exemption would be necessary to make a judgement.	Some CESR/CEBS members believe that the full application of *CRD* requirements to *specialist commodity derivatives firms* would be too burdensome. Other members however see no evidence for that. Therefore, two alternative options are presented in the final advice. One is along the lines of options 1 and 2 of the Consultation Paper, the other proposes full *CRD* application (option 4 of the Consultation Paper) with a limited exemption.
31. Do you think a complementary opt-in or opt-out regime could be helpful?	Most respondents thought that such a complementary regime could be useful. One respondent thought it would lead to uncertainty.	On the *MiFID* exemptions, CESR/CEBS have recommended in the final advice that the Commission should consider providing legal certainty that firms which fall under the *MiFID* exemptions should be considered so are able to apply for a licence under the directive. The under option 2 it is proposed to

		provide an opt-out from any prudential requirements for firms where this would not impede the overall aims of prudential regulation. *CRD* treatment solution. Please see Part D, *MiFID* questions 4 and 6 and Part F, *CRD* questions 4 and 6.