



The Chairman of the Board of Regulators



The CEER President

London, 24 September 2012

Mr Jonathan Faull
Director General
DG MARKT
European Commission
1049 Brussels
Belgium

Re: Impact of European Financial Regulations on Energy Markets

Dear Mr Faull,

I am writing on behalf of Europe's energy regulators, both as Chair of the Board of Regulators of the Agency for the Cooperation of Energy Regulators (ACER) Board of Regulators and President of the Council for European Energy Regulators (CEER) to express our concerns regarding the impending changes to European financial regulations. While we note the important work being undertaken in this area and are supportive of such reforms, we have concerns over the potential unintended consequences of the proposed changes. Specifically, we are concerned about the impact of such changes on European energy markets, and their potential to undermine the objectives of the 'Third Energy Package'.

Our primary concern over the impending changes to European financial regulations relates to the revision of the Markets in Financial Instruments Directive (MiFID II & MiFIR). In particular, we note that there is uncertainty among NRAs and market participants over the definition of 'financial instruments' under MiFID II (Annex 1.C.1.6-10) and whether this is intended to capture physically settled forward contracts, which form a key component of wholesale energy markets. It is our understanding that the effect of such capture could potentially extend the compulsory clearing and reporting requirements of the European Market Infrastructure Regulation (EMIR), and the minimum capital requirements of the Capital Requirements Directive (CRD IV) to both bilateral and over the counter trading in such products by energy firms.

In the event that physically settled forward contracts are, and are intended to be, classified as 'financial instruments' under MiFID II, regulators are of the view that this could result in a negative impact on European energy markets. Furthermore, this could potentially constrain the market liberalisation objectives of the Third Energy Package through:

- Reduced Liquidity – by imposing compulsory clearing requirements on physically settled forward contracts, there is the potential for an increase in trading costs, and as a consequence a reduction in liquidity in energy markets;
- Reduced competition – the potential for further capital requirements under CRD IV may potentially act as a deterrent and/or restrict access for new entrants; and
- Reduction in investment – the potential for higher costs associated with compulsory clearing under EMIR and the further capital requirements under CRD IV have the potential to deter some new investments in energy infrastructure, due to lower expected returns on equity.

Taken together we consider that the potential for higher trading costs, reduced liquidity, reduced competition and further capital requirements are likely to outweigh the benefits that will arise for energy consumers from a reduction in systemic risk. We have taken this view on the basis of differences between energy and financial markets which mean that the nature of risk is different and as such the potential benefits from greater regulation are likely to be reduced. In particular:

- Physically settled forward contracts are usually settled by energy firms through the physical delivery of the underlying commodity;
- Transactions in such contracts by energy firms are underpinned by real physical assets;
- The majority of trading in physically settled forward contracts is for commercial and not for speculative purposes; and
- Energy firms operate in a supervised market and are subject to an existing administration regime to ensure continuity of service, and tend not to use complex financial products.

There is significant uncertainty among NRAs and market participants regarding the definition of 'financial instruments' under MiFID II and its application towards physically settled forward contracts. Should such products be classified as 'financial instruments' and hence fall within the scope of MiFID II (and MiFIR), EMIR and CRD IV, the objectives of the Third Energy Package could be undermined in terms of reduced liquidity, reduced competition and potentially lower investment. If this were to occur, the result would be a reduction of the net benefit intended to arise to consumers as a result of the introduction of the Package.

Given the advanced stage of discussions (specifically, the amendments already tabled in the context of the ECON Committee report on MiFID II and the imminent vote in ECON on 26 September) our concerns would be attenuated by accepting the amendments being considered in the ECON Committee as set out in the Annex to the letter. By way of explanation: AM 248 (exemption for TSOs and their service providers when issuing transmission rights); and AMs 1307 and 1310 (exclusion of physical forwards from definition of financial instruments; such physical forwards, in the case of energy, are automatically covered by REMIT).

Please let me know if we can arrange a discussion with your services to discuss this important issue.



This letter has been also sent to:

Cc: Markus Ferber (European Parliament), Robert Goebbels (European Parliament), Olle Schmidt (European Parliament), Sven Giegold (European Parliament), Kay Swinburne (European Parliament), Jürgen Klute (European Parliament), Inge Bernaerts (European Commission, DG ENER), Marios Stephanides (Cyprus Presidency), Ellie Stylianou (Cyprus Presidency), Constantinos Trikoupis (Cyprus Presidency), Stella Livadiotou (Cyprus Presidency), Christos Papoutsas (Cyprus Presidency)

ANNEX 1: ECON Amendments to Article 2 – paragraph 1 – point n and Annex 1 – Section C – points 6 and 7

1) Extension of the exemption of Article 2(1)(n) not only to TSOs but also to other entities performing the tasks on behalf of TSOs, and for the sake of European power markets integration

This issue relates to the fact that there is currently legal uncertainty as the exemption in Article 2(1)(n) is only related to TSOs, not to their service provider like a common auction office (e.g. CASC or CAO). ACER referred to this issue in its recommendation in February 2012 (01/2012). We believe that the exemption should be extended but so far this is not reflected in the text. As those service entities performing tasks of the Third Package on behalf of TSOs are highly important for the European power markets integration process, we would support the extension of the exemption and the equal treatment of TSOs and entities performing the tasks on their behalf.

Amendment 248

Werner Langen

Proposal for a directive

Recital 22 a (new)

Text proposed by the Commission

Amendment

(22 a) For a well-functioning internal market in electricity and natural gas, and for the carrying out of the Transmission System Operators' (TSOs) tasks under Directive 2009/72/EC, Directive 2009/73/EC, Regulation (EC) No 714/2009, Regulation (EC) No 715/2009, or network codes and guidelines adopted pursuant to those Regulations, it is necessary that TSOs and their service providers are exempted when issuing transmission rights, in the form of either Physical Transmission Rights or Financial Transmission Rights, and when providing a platform for secondary trading. In order to enable efficient trade in transmission rights it is further necessary to exempt any person when buying or selling those transmission rights.

NEW AMENDMENT SUGGESTION:

Article 2 – paragraph 1 – point n

Text proposed by the Commission

(n) transmission system operators as defined in Article 2(4) of Directive 2009/72/EC or Article 2(4) of Directive 2009/73/EC when carrying out **their** tasks under those Directives or Regulation (EC) 714/2009 or Regulation (EC) 715/2009 or network codes or guidelines adopted pursuant those Regulations.

Amendment

(n) transmission system operators as defined in Article 2(4) of Directive 2009/72/EC or Article 2(4) of Directive 2009/73/EC **and persons acting as their service providers** when carrying out **the** tasks **of transmission system operators** under those Directives or Regulation (EC) 714/2009 or Regulation (EC) 715/2009 or network codes or guidelines adopted pursuant those Regulations, **such as the issuance of transmission rights and the provision of a platform for secondary trading, and any other persons when buying and/or selling such transmission rights; this exemption applies only with regard to the aforementioned activities.**

2) Clarifications to exempt physically settled forward contracts

With regard to a clarification that physically settled forward contracts should not be considered as financial instruments, the amendment proposals **1307 and 1310** on the definitions in Annex I Section C Points 6 und 7 (made by MEPs Langen and Schmidt on the draft report of MEP Ferber to the ECON-committee) might address this concern:

Annex 1 – Section C – point 6 (Combines wording from AMs 1307 and 1310)

Text proposed by the Commission

(6) Options, futures, swaps, and any other derivative contract relating to commodities that **can** be physically settled provided that they are traded on a regulated market , OTF, or an MTF;

Amendment

(6) Options, futures, swaps, and any other derivative contract relating to commodities that **are not intended to** be physically settled provided that they are traded on a regulated market, OTF, or an MTF;

Annex 1 – Section C – point 7

Text proposed by the Commission

(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 regards to

Amendment

(7) Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that **are not intended to** be physically settled not otherwise mentioned in C.6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments,

whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls;

having regards to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls;