Market Abuse Directive – Call for Evidence

EFET, 12.06.2009

The following document summarises the points made in the Call for Evidence – Review of Directive 2003/6/EC on insider dealing and market manipulation (Market Abuse Directive) – ("CfE") and shows the detailed questions which are asked and the responses of EFET in relation to these:

EFET works to promote the development of a sustainable and liquid European wholesale market in electricity and gas, as well as in related physical commodities and derivative contracts. EFET is complementary to existing industry organizations in Europe as it is solely dedicated to energy trading issues, and lists over 100 firms as members.

1 Only regulated markets? (Articles 1(3) and 9 of Directive 2003/6/EC):

The services of the European Commission recognise that there are divergent arguments as to the extension of the scope of MAD to "non-regulated markets". However, bearing in mind the need to secure integrity of markets and to ensure a level playing field between regulated markets and alternative trading platforms it is worth examining the possibility of extending the MAD scope to MTFs.

1.1 Do you consider that the scope of the MAD should go beyond regulated markets? In particular, should it be extended to cover MTFs?

We strongly support the need for a regime ensuring the integrity of markets and which delivers sufficient transparency for the development of liquid and efficient markets. However, the MAD has been designed for regulated financial markets and we do not see a need or a benefit of a formal extension to non-regulated markets as it would not be a proportionate regulatory step.

EFET concludes that there is no regulatory need to extend the market abuse regime to cover transactions in commodity and exotic/hybrid derivatives executed on MTFs:

MiFID already guarantees a sufficient degree of market integrity at MTFs (see Art. 26 of MAD) as it requires investment firms and market operators to monitor transactions undertaken on the MTF that may involve abuse. Furthermore MTF's are required to report such conduct to the competent authority and provide further assistance as appropriate – for example in the event of any investigation by the regulatory authorities. Also, the operation of MTFs is an investment service, which needs to be licensed under MiFID (Art. 5 of the MiFID) and needs to fulfil certain legal prerequisites. Consequently, these licensed investment firms/operators are subject to the organisational and conduct-of-business rules of MiFID.

This, together with other regulatory measures, ensures that there is already sufficient investor protection, transparency and market integrity within MTF's.[1]

Furthermore, we agree with the technical arguments against an extension mentioned in the CfE on page 5.

EFET does not believe that small differences in arrangements across countries currently constitute a barrier to trade (as in practice they are not material) – and as such the benefits from "ensuring a level playing field" will be small. The task of fine tuning the national arrangements could lead to the adoption of "harmonising" regulatory provisions, bringing a risk that these provisions then diverge from or overlap with slightly disparate national arrangements and create confusion.

2 What kind of financial instruments should be covered by the MAD, especially in comparison with the MiFID? (Article 1(3) of Directive 2003/6/EC)

In order to clarify the scope of application of the MAD in relation to the various types of financial instruments currently traded on the EU financial markets, the definition of financial instruments in the MAD could be aligned with the definition of financial instruments provided for in MiFID.

2.1 Do you agree with an alignment of the MAD definition of financial instrument to the definition for the same concept provided for in MiFID? Do you think it could be useful to explain in more detail in the MAD what is meant by a financial instrument "whose value depends on another financial instrument" or to list asset classes, such as CFDs and CDS, which belong to this category?

We welcome a consistent treatment in the MAD and MiFID, which is sufficiently able to ensure market integrity and transparency avoiding conflicting sets of regulation. Therefore, alignment of the definition of a financial instrument as given in MiFID is appropriate in the light of a further harmonisation of EU regulations.[2]

It would be helpful in terms of application of MAD if the definitions of commodity derivatives and exotics/hybrid derivatives could be defined through reference to the corresponding definitions in MiFID. A clarification of the definition of a financial instrument in MAD by reference to the corresponding definition in MiFID could help market participants to have a clearer view as regards the scope of applications of MAD. This aim could be achieved by adding a reference to the definition given by the MiFID as far as regulated markets are concerned. MiFID defines in Annex I Section C no. 5-7 the scope of the term commodity derivatives and in its An-

[1] See also: Report on commodity derivatives of European Securities Markets Expert Group (ESME), page 111 – 113 ("ESME-Report"); see under: http://ec.europa.eu/internal_market/securities/docs/esme/commodity_derivatives_en.pdf

[2] See also ESME-Report, pages 98 – 101.

nex I Section C no. 10 a further class of other non-financial derivatives, such as derivatives linked to weather, emissions allowances, freight rates and economic statistics (here referred to as "exotic/hybrids derivatives").

This harmonisation should not, however, broaden the scope of the MAD to new kinds of financial instruments beyond its existing scope. Applying the aforementioned MiFID definition should ensure that the MAD is not extended to the underlying (physical) market, i.e. no extension of the scope of MAD beyond the commodity derivative/exotic derivative markets into the underlying spot markets or to OTC forward physical trading. Hence, the current restriction of application pursuant to Art. 9 of MAD needs to be preserved.

However, the application of MAD to energy commodity derivatives should be reviewed and in the event that a new comprehensive EU Regime for Market Integrity and Transparency is created (see item 3.1 below).

3 The specific case of commodity derivatives markets (Article 1(1) of Directive 2003/6/EC)

A tailor-made market abuse framework for physical markets in a separate piece of legislation (not in financial services regulation) and an interface between regulators concerned could be a possible way forward.

3.1 Do you see a need for introduction of a market abuse framework for physical markets?

In EFET's view, "fundamental data" refers to information about the availability and use of energy infrastructure. Market transparency is crucial to the successful development of an efficient wholesale market. To compete effectively in the wholesale market, all wholesale market participants – traders, generators and retailers - need to be able to predict the likely evolution of supply and demand fundamentals. Participants base these predictions on analysis of a number of factors including expected levels of future demand, transmission capacity, generation and production capacity, but also by detailed analysis of actual events in the past and the observed impact on prices. The release of such information – both before and after the date of delivery - is therefore crucial to market participants' ability to analyse likely market developments and to participate effectively in wholesale markets.

EFET is of the opinion that an extension of MAD, in its current form, to OTC markets and spot markets in commodities, commodity derivatives and exotic/hybrid derivatives is not recommendable on the basis of the reasons explained by CESR and ERGEG[3] and ESME[4]. Such a "one-size-fits-all" approach would not address the needs and specific features of energy markets. Therefore, the physical energy markets should not be dealt with by MAD as it is currently framed.

[3] See CESR/ERGEG advice on commodity derivatives; October 2008; see under: http://www.cesr.eu/index.php?docid=5270

[4] See ESME-Report, pages 114 to 115.

Following the recommendations by CESR and ERGEG we support a tailor-made approach for energy markets. We recommend the introduction of an EU-wide binding specific Market Integrity and Transparency regime within the energy sector legislation, i.e. by an EU Regulation (the "EU Regime").[5]

This EU Regime should include a transparency regime and a market integrity regime:

As proposed by CESR-ERGEG, the transparency regime should consist of transparency in respect of fundamental and anonymous data showing the volume and pricing of concluded, standard wholesale transactions:

- *Transparency of fundamental data* means disclosure of data which has an effect on the price formation process for power and gas products, such as information on generation, production, transmission, storage, LNG and consumption. It is necessary to define in an explicit manner the relevant fundamental data and the manner of the publication as such (timing, aggregation, etc.) to guarantee clarity of the EU Fundamental Data Regime and certainty for market participants. There will be a need to consider how transparency requirements under a new regime would interact with existing requirements under EU energy legislation as specified in the Third Package which has recently been agreed.
- *Post-trade transparency* refers to the publication of trade information on executed transaction in respect of power and gas products on a real/near real-time basis ("*Post Trade Transparency*"). Trade Transaction means standardized transaction on Regulated Markets, Regulated Multilateral Trading Platforms (MTFs) and OTC-Markets (broker platforms). It is necessary to define in an explicit manner the relevant data and the manner of the publication as such (timing, aggregation, etc.) to guarantee clarity of the EU Post Trade Regime and certainty for market participants. EFET is of the view that the responsibility for publishing post-trade information should rest primarily on operators of regulated exchanges and MTFs and brokers. This will help ensure the most efficient and practical release of such information so that "everyone can see what the market sees".

Market Integrity Regime consists of Insider Dealing Regime and Market Manipulation Regime:

- The insider dealing regime and the definition of insider definition need to be tailor-made. It is necessary to define exactly what constitutes insider dealing and insider information based on the above-mentioned definition of fundamental data.
- An exact definition of what constitutes a market manipulation is necessary to guarantee regulatory clarity and certainty for market participants and such definition should be tailor-made. The regime needs to address specifically issues around the energy sector, e.g.

[5] This ensures a harmonized and EU-wide level playing field. A voluntary regime would not ensure harmonized obligation and application and hinders in practice a level-playing field across the EU, because different voluntary regimes would be created in the different Member States.

power production or trading / sales activities, i.e. withdrawing capacity, imposing high prices, etc.

EFET believes that such EU Regime would further improve the reliability of open and competitive energy trading wholesale markets and the trust participants have in the market and its price building mechanisms and, hence, foster further market development and liquidity. .

To reach these aims the EU Regime shall be drafted along the lines of pre-defined general principles which are:

- As proposed by CESR-ERGEG, the main aims are market transparency and market integrity and these are clearly to be stated and respected in the further legislative process.
- This EU Regime is tailor-made to the energy trading markets, its products, participants and market places: This EU Regime should take into account the specifics of the energy markets and shall not be a „copy-past-exercise“on the basis of the existing financial market regulations.
- This EU Regime shall be comprehensive:
  - The scope should cover all products traded on EU energy trading markets – although it is likely that this will be limited to power, gas and CO2 products.
  - This would encompass products traded on regulated markets, MTFs and OTC-markets and products which are physically and financially settled.
- Must respect the better regulation principle - appropriate and proportionate to its objectives.
- A right borderline / delineation and coordination between the different areas of regulation and the EU Regime needs to be drawn:
  - The new EU Regime shall not contradict and overlap with other relevant EU legislation, such as the MAD and antitrust law and the competencies of the respective regulators. Duplication/contradiction of regulation will create uncertainty as to which legal framework should apply including the appropriate authority entitled to pursue any cases.
  - The interaction between energy, anti-trust and financial regulators will be crucial to making any regime work effectively. Clear obligations and responsibilities must be outlined in any legislation.
  - EFET has considered the merits of the inclusion of European wholesale markets in oil and coal under the regime and decided against the desirability for the time being.

4 Definition of inside information: the general definition (Article 1(1) of Directive 2003/6/EC and Article 1 of Directive 2003/124/EC) and the particular definition for commodity derivatives

In this context, there does not seem to be a need to revise the concepts used to define inside information for MAD purposes.

4.1 Do you share this view as far as insider dealing prohibition is concerned? (see also next point for disclosure of inside information). If not, which concepts would you advise to modify and how?

In respect of the general financial markets (excluding commodity derivatives) we do share this view as far as the general definition of inside information (Article 1(1) of MAD and Article 1 of Directive 2003/124/EC) is concerned; see also our comments under item 4.2 below.

The current MAD provisions on this issue may not offer sufficient certainty. Alignment of the definition of inside information for commodity derivatives with the general definition given by the MAD could be considered. However, if new obligations on public disclosure in the physical commodities markets were tailored in the short to medium term as a consequence of the Third Energy Package, we may need to reassess whether maintenance of the status quo is more appropriate

4.2 Do you support an alignment of the inside information definition for commodity derivatives with the general definition of the directive?

EFET is of the opinion that neither the general definition of inside information nor the particular definition of inside information for commodity derivatives in Article 4 of Directive 2004/72/EC are appropriate to solve the practical problems of the application of the MAD-regime on commodity derivatives business, in particular in the energy business.[6]

The vague scope of inside information definition leads to uncertainty as to what types of information might constitute inside information. The test pursuant to Art. 4 of Directive 2004/72/EC could result in a too wide application of MAD as there are / (and with implementation of the 3rd Energy Package) will be many voluntary or obligatory disclosure of data.

Also, the general concept of disclosure requirement, as set our in Article 6 (1) of MAD[7], does not fit into the commodity markets as the issuers of commodity derivatives in regulated markets are actually the operators of the regulated market and not the individual market participants themselves, e.g. European Energy Exchange ("EEX") for EEX future products (see under: www.eex.de).

Consequently, EFET is of the opinion that there is not only a need to align the particular definition of inside information for commodity derivatives with the general definition of MAD, but also to further develop and adapt the insider dealing regime to the needs of the commodity and commodity derivatives business.

[6] Reference is made insofar to the ESME-Report, pages 102 – 110.

[7] "Member States shall ensure that issuers of financial instruments inform the public as soon as possible of inside information which directly concerns the said issuers."

However, in respect of the energy markets the above-mentioned problems of the current provisions would be solved in a more targeted manner and more effectively by the envisaged tailor-made EU regime. Only such a specific regulation can define a set of rules which guarantees the orderly functioning of the energy markets and take the specifics of energy markets into account.

5 Dissemination of inside information and deferred disclosure mechanism (Article 6 of Directive 2003/6/EC and Article 3 of Directive 2003/124/EC)

At this stage, no changes in the definition of inside information for disclosure purposes would seem to be justified.

5.1 Do you consider that any changes to the definition of inside information for disclosure purposes is necessary?

We do agree with this assessment; but see item 4.2 above.

It may be necessary to revisit the mechanism for deferred disclosure of inside information in order to ensure (i) that the conditions for the use of this possibility are sufficiently precise and (ii) that when the viability of an issuer is at stake, they are not unduly stringent. It may be worth examining whether exemptions to the obligation of disclosure of inside information should be broadened and should exclude financial stability measures from such an obligation. Effecting changes or providing clarifications in this area may imply changes to Level 1 and/or Level 2 measures.

5.2 Do you agree that the described deficiencies of the deferred disclosure mechanism need to be addressed, possibly by way of amendments to the MAD framework? Do you consider that Level 3 guidance could be sufficient?

No comments, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

5.3 Do you agree that the issuer may be exempted from disclosing inside information in situations when that information concerns emergency measures being prepared in case the issuer's financial stability is endangered?

No comments, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

5.4 What are other deficiencies in this area that raise major interpretation / application difficulties? What is the best way to address them?

No comments, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

Consideration should be given to reviewing the obligation to disseminate inside information for commodity derivatives issuers (e.g. electricity and gas derivatives).

5.5 Do you agree with this approach? Can you identify cases where a modification or deletion of the obligation may be undesirable for market integrity?

Please see our comments under item 4.2 above.

6 Prohibition of insider dealing (Articles 2, 3 and 4 of Directive 2003/6/EC)

This matter has been recently brought to the attention of the European Court of Justice (ECJ), in the context of a preliminary ruling requested by a court in Belgium. At this stage, there is merit in considering the ECJ preliminary ruling before the services of the European Commission envisage measures that would seek to clarify this apparent divergence.

6.1 Would you support this approach?

No comments, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

7 Insider lists (Article 6(3) of Directive 2003/6/EC and Article 5 of Directive 2004/72/EC)

The rules on insider lists may need to be re-examined in order to address concerns regarding the balance between their efficiency and the burden they entail for the entities obliged to produce them. Due consideration needs to be given to problems with legal certainty, consistency at EU level or workability of the insider lists' requirement in specific circumstances.

7.1 Do you consider that the obligations to draw up lists of insiders are proportionate?

No comments, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

8 Transaction reporting by managers and closely associated persons and subsequent disclosure (Article 6(4) of Directive 2003/6/EC and Article 6 of Directive 2004/72/EC)

It may be necessary to reassess this measure and consider whether it provides for sufficient legal certainty.

8.1 Do you see a need for a regulatory action in the above areas? Would you suggest further improvements?

No comment, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

9 Reporting of suspicious transactions (Article 6(9) of Directive 2003/6/EC and Article 7(11) of Directive 2004/72/EC)

The advantages of this measure seem to largely outweigh any regulatory burden. However, level 1 or 2 changes could still be envisaged in order to enhance the efficiency of the reporting mechanism.

9.1 Do you agree that rules on suspicious transactions reporting do not require modifications?

No comment, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

10 The competent authorities' right of access to telephone and existing data traffic records (Article 12 of Directive 2003/6/EC)

It may be necessary to amend the MAD and/or the e-privacy Directive, in order to remove any uncertainties on the rights of the competent authorities to require this data. Article 12(2)(d) of Directive 2003/6/EC could clearly state that the power of competent authorities to require existing telephone and data traffic records in the course of their proceedings against market abuse are not limited by confidentiality restraints or other limitations on entities possessing such records that may stem from the e-privacy Directive.

10.1 Do you consider that an amendment of the MAD is necessary?

No comment, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

11 Definition of market manipulation by transactions/orders to trade (Article 1(2) of Directive 2003/6/EC)

As a consequence, no legislative change is envisaged.

11.1 Do you think that the definition of market manipulation should be amended? If this is the case, what elements of the definition should be reconsidered?

No comments, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD; but see our comments under item 3.1 above.

12 Accepted market practices (AMP) (Articles 1(2)(a) and 1(5) of Directive 2003/6/EC)

At this stage, consideration should be given to whether further level 3 work on this topic could help.

12.1 Do you consider that the rules on accepted market practices should be amended in the MAD? Do you think there is room for greater convergence among competent authorities in this area?

No comments, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

13 Exemption for buy-back programmes and stabilisation activities (Article 8 of Directive 2003/6/EC and Commission Regulation 2273/2003)

Not all buy-back programmes and stabilisation activities should benefit from an outright exemption (safe harbour) under the MAD rules. Even if some of them are currently not included within the scope of Regulation 2273/2003, they are not to be automatically considered as manipulative behaviour. There may be merit in considering the specific areas where greater convergence would be desirable in the application of these rules.

13.1 Do you consider that the safe harbours for buy -back programmes and stabilisation activities should be revisited? Do you think that greater convergence is desirable in the application of the Regulation 2273/2003? What would be the most appropriate way forward in this respect?

No comments, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

14 Short selling

The definition of short selling does not reflect the business of commodity trading and therefore, is by nature not applicable to the energy industry.

14.1 Do you see a need for a comprehensive framework for short selling? If so, should it be addressed in the Market Abuse Directive? What issues should such a regime cover?

No comments, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

14.2 Should short sellers be required to report positions to competent authorities? Under which conditions should naked short selling be allowed? Should competent authorities be able to take emergency measures (e.g. temporary bans on short selling or on naked short selling) within prescribed limits when they need to address specific market risks and disruptions?

No comments, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

14.3 Is there a need to enhance risk management by financial intermediaries and banks? Should investment firms and banks be required to have necessary ar-

rangements in place to ensure timely delivery of financial instruments traded on own account or in the context of execution of clients' orders?

No comments, because the EFET-Position is in preference to a tailor-made regime instead of amendments to the MAD.

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