

**Conference on the MiFID review and commodity and exotic
derivatives
20-21 September 2010
Summary**

DAY 1

Opening Speeches

Jonathan Faull (Director General, DG Internal Market and Services, European Commission) welcomed all participants and attendees to the conference. He noted the backdrop of intense regulatory reform in the financial sector and the vital role MiFID has to play in this. In particular Mr Faull saw five areas where targeted modifications were needed: increased organisation, transparency and oversight of various market segments; continued progress towards a genuine single market for investment services; appropriate regulation to keep pace with increasing competition, fragmentation and speed; amendments to meet the new European supervisory structure; and finally, additional transparency and oversight measures in the commodity derivatives market.

Michel Barnier (Commissioner, Internal Market and Services, European Commission) noted the importance of MiFID, and its success to date; however he also noted that since the original proposal was drafted, the financial world has witnessed deep changes which justify this review. Commissioner Barnier stated that questions raised by the crisis must not remain unanswered and that he sought to fulfil four key objectives – increased accountability for financial actors; transparency for all; continuation of fair competition; and restoring confidence in the markets and financial intermediaries. He noted that these objectives apply comprehensively across the financial landscape and that no markets, activities or players will be left aside, including commodity derivative markets. He said that the Commission would adopt a proposal in spring 2011.

Dacian Cioloş (Commissioner, Agriculture and Rural Development, European Commission) expressed his concern about the impact on agriculture of excessive speculation on financial markets. He noted that across Europe farmers, various food industry players and processors and consumers were all seeking increased market transparency. The Commission must take measures against the extreme volatility of prices of agricultural products. Commissioner Cioloş cited the fluctuations in the milk market over the period 2007-2009 and underlined that speculation should not put in danger farms otherwise perfectly viable in normal times. Asking for more transparency of the financial markets and more supervision for the derivatives markets, Commissioner Cioloş stated that the future reform of the Common Agriculture Policy will include more elements to fight the volatility of prices and the decrease in farmers' incomes.

In her keynote speech, Sharon Bowles MEP (Chair, Economic and Monetary Affairs Committee, European Parliament) considered that although there are many recent events from which lessons can be learned, the ultimate consideration of MiFID should be the needs of users and investors – these being choice and protection. Mrs

Bowles commented that there are times when the needs, interests and incentives of the individual and the whole are not always the same, and that this presents tough political decisions. In meeting these decisions key principles must be considered – recognition of the difference between wholesale and retail markets; non discriminatory choice and regulation that is appropriate to its level; recognising that liquidity and transparency can sometimes be a trade off and that different asset classes behave differently; and that markets are organic and can not be forced. In particular, she questioned if the appropriate balance for pre trade equity transparency had been struck, in view of the growth of dark trading. She also noted the technical changes in the market (e.g. new types of trading and increased fragmentation), the strong case to move to intra-day monitoring, if not the banning on some types of trading - such as flash orders, and the need to move towards a consolidated tape of trade data.

In the final keynote speech, Carlos Tavares (Chairman, CESR) highlighted the progress made so far, but also the need to further develop MiFID. He queried whether fragmentation had increased liquidity - citing that mitigating systems (to provide consolidated information to investors and regulators) are still far from being complete, and summarised seven key points to be considered in the review – enhanced transaction reporting; *urgently* implement a consolidated tape; review the best execution concept; reduce opportunities for regulatory divergence; strengthen investor protection; increase pre and post trade transparency; and regulate new trading modalities e.g. high frequency/algorithmic trading. Mr Tavares also noted that the review should anticipate the newly created ESMA and leave room for this to implement principles via technical standards. Mr Tavares concluded that markets have proved to be dynamic and creative in building new solutions and so regulation must be flexible and agile.

Panel I Derivatives – geared for a paradigm shift

The moderator, Georges Ugeux (Galileo Global Advisors), opened the debate by recalling the context of the financial crisis, the US legislative reform and the recent Commission proposal on OTC derivatives.

Brendan Bradley (Eurex) underlined that trading on organised venues and OTC has been largely complementary. One of the key differences between the two was the level of pre trade transparency which has not been fully addressed in recent consultation as the focus has been placed on post trade transparency and the availability of CCP services. As a result he suggested that the standardisation approach and the possibility for organised trading should broadly follow the US regulatory approach and that European regulators should provide for a level playing field between regulated markets and MTFs given the similarities that exist in their execution functions.

Erik Litvack (Société Générale) came back to the statement of the G20 in Pittsburgh on trading of all standardised derivatives on organised venues where appropriate. He underlines the differences and complementarities between trading on regulated markets which can maximise turnover and liquidity and fits benchmark products and trading OTC which offers maximum flexibility for users but less frequency of trading. Post trade transparency for OTC products could be possible only if counterparty risk is excluded, otherwise it will create misleading price signals. He insisted on the need

to define the reasons for more transparency and the fact that there will likely be a trade off between more transparency and the willingness of dealers to trade.

Håkan Feuk (E.ON Energy Trading) underlined the fact that it was crucial to allow efficient hedging for corporates, especially in the energy markets. Pushing more trading onto regulated markets could achieve increased liquidity but sufficient flexibility should be kept to allow effective hedging. For firms which have small volumes to transact, OTC is more efficient and non financial firms should be able to choose the most efficient venue. Current exemptions for commodity firms should remain.

Rich Silts (CFTC), speaking in a personal capacity, confirmed the willingness of US regulators to achieve consistency on both sides of the Atlantic. He gave a summary of the US reform and subsequent rules which are being drafted. Among other reforms, he mentioned swap execution facilities (SEFs), the main features of which would be trade transparency and multiple participants on both supply and demand sides.

Matt Woodhams (GFI) mentioned that electronic trading was more developed in Europe than in the US. A balance should be found between transparency and liquidity. Suitable trading venues need to be created possibly by reproducing the SEF concept in MiFID.

The rest of the discussion focused on the different recipients of trade transparency. There was a rather larger consensus for a complete and full transparency for regulators but only high level transparency for the public.

Panel II Transparency, efficiency and soundness in the trading of financial instruments

The moderator, Alexander Justham (UK FSA), recalled the objectives behind a regulatory framework for transparency of trading, namely a balance between private and public interests in support of fair, robust and efficient markets. He noted that fragmentation of trading and data in the wake of MiFID, as well as rapid technological developments, underline the need for regulation of transparency to keep pace.

Scott Cowling (Blackrock) said a review of MiFID transparency rules should seek to enhance, not rewrite the status quo. Equity market transparency was largely satisfactory, while non-equity transparency should be pursued in the same vein, with instantaneous publication whenever participants were not on risk, and allowing for suitable delays in other cases in order to avoid impairing clients' and participants' interests and damaging liquidity. He questioned whether many equity trades occurring OTC were relevant for price discovery purposes.

Roland Bellegarde (NYSE Euronext) said that there had been a big increase in opacity and OTC trading in equities since MiFID. He said a large number of equity trades occurring OTC were in fact of a small size and thus did not need the confidentiality associated with OTC trading. The future ESMA should have the capability and agility to address loopholes in the framework of transparency in order

to mitigate private interests from circumventing and compromising commonly established rules.

Roger Barton (Tradeweb) said that trading in various fixed income non-equity markets is often characterised by relatively fewer numbers of trades, but in large sizes. Matching of clients' interests is unlikely and thus facilitated by dealers. Traditional means of executing trades by phone are increasingly giving way to electronic platforms, which adjust levels of transparency provided according to the needs of market users.

Massimo Mocio (Banca IMI) recalled that the Italian transparency regime was more extensive than MiFID. He said that while it had not played a direct role in supporting Italian banks during the crisis, it did serve to remind that liquidity and dealers' capital commitment in various non-equity markets can be fragile. Financial institutions should help regulators formulate ambitious and balanced transparency rules, and that CESR's recent advice to the Commission was a good compromise.

Stephen Luparello (FINRA) said that, in relation to equities, the US was mostly focused on improving pre-trade transparency and transparency towards regulators, due to the challenges posed by dark pools and fragmentation between competing venues. As for non-equities, he said the TRACE model provided the necessary transparency for regulators, while achieving the right balance in transparency towards the market was always in flux.

In the discussion that followed greater clarity was sought on the size and nature of the OTC market in equities, whether there was a future for the systematic internaliser regime, and how transparency and various execution arrangements in non-equities would look like in the future.

Panel III The changing face of trading – achieving a level-playing field for trading venues and market participants

The moderator, Karel Lannoo (CEPS), observed that the questions analysed by the panel are similar to those in 2001 when MiFID was elaborated, namely the one of the balance between transparency and fragmentation, though the context has changed since. He also pointed out that MiFID has achieved its primary objectives of reducing fees and spreads, but more attention needs to be given to conduct of business rules and to markets other than equity markets.

David Lester (LSE) emphasized the success of MiFID in abolishing monopolies of national exchanges, in creating possibilities for new trading venues to appear, in bringing more choice and in reducing trading fees and spreads through modern technology. MTFs continue to gain market share. Harmonised data standards would allow effective consolidation of post-trade data by the industry and would enhance the transparency of the European equity market. Dark pools are an important component of the choice available to market participants, but all dark trading venues should be able to execute within the spread to deliver price improvement. Competition in trading must be supported by an efficient and cost effective post-trade environment. Finally, SME access to capital should be supported to help drive economic growth and job creation. In the UK, the AIM market has been a success.

Kelly Riley (US SEC), speaking in a personal capacity, underlined that markets have changed with automation, but also with the increase in the number of market participants. Applicable SEC regulation is similar to MiFID but has several differences due to market changes as regards for example best execution, information requirements, as well as order matching and the consolidation of quotations to determine one national best bid and offer. The order protection rule requires trading centres to direct the order to the venue offering the best price when they can't offer it themselves. Dealers also have to respect this rule for clients. Following the flash-crash, the SEC issued different proposals on regulating high-frequency trading, dark pools, flash orders and transparency in order to achieve investor protection and fair markets.

According to Jonathan Eardley (QCA/European Issuers) listing rules under MiFID are not prohibitive for large firms and there is no evidence of a need to change this for large caps. However, for small illiquid caps, rules need to be proportionate. The role of the Commission and of national government is to foster competition. This does not necessarily need to be done through uniform markets. On the contrary, markets have to meet investors' expectations..

Eleanor Jenkins (Morgan Stanley) expressed the view that the key driver to the success of the markets today is the choice of execution methods for different orders. These execution methods are not mutually exclusive. She pointed out that better understanding is needed regarding different types of models including the methods and organisation of crossing systems. The working group set up by CESR should improve the quality of post-trade data. Without this, a consolidated tape would make little sense. She expressed the wish that regulation be evidence-based. According to her, there was no significant increase in OTC trading after MiFID, but the methods of trading have changed. With regards to Broker Crossing Systems, this activity does not represent a material proportion of pan-European trading and arguably has no effect on price formation. Moreover, the provision of capital for risk filling purposes, which by its nature has to remain OTC, has always been a core broker activity and provides an important and valued service to institutional, retail and corporate clients. Integral to this is the ability of a broker to delay the publication of large risk trades and it would be damaging to European liquidity, especially in illiquid securities if this ability were to be taken away. Finally, the systematic internaliser regime is not achieving its aim. It makes little sense to mandate pre-trade transparency when only the investment firms' clients can interact with the quotes generated creating unnecessary noise on the tape.

John Woodman (Chi-X Europe) underlined that one person's level playing field is another's disadvantage, because investment objectives differ, for instance according to the time of the investment and the type of investor. Fostering choice of venues according to the characteristics of the order has been one of the main benefits of MiFID. Lower execution costs are important for efficiency, but the question is if new trading venues piggy back on existing exchanges, including taking the most lucrative part of the activity of regulated markets. He believes this is not the case, because new venues have grown the total market. Moreover, price formation occurs in new venues also and is more than centralising orders in a book. It is also about post-trade information from all venues. Concerning high frequency trading, made possible by

technological developments, he considers it helps provide liquidity to markets and thereby drive execution costs down. Provided the risks of market abuse are prevented through the application of existing rules, high frequency business should not be inhibited unless it proves abusive or harmful. In this context, short-selling is also a valuable service, a natural adaptation of the market. The focus now should be on encouraging cheaper post-trading systems and on providing more consistent post trade information.

Judith Hardt (FESE) said that regulated markets played a key role in providing liquidity during the crisis, which shows that the structure of the markets they operate (neutral, robust, open, etc) brings real benefits to the whole economy. MiFID has had a positive impact on improving competition among regulated venues, enabling pan-European trading and reducing execution costs. However, MiFID has not increased choice for all and has not increased competition between all market players. There is a big amount of trading on unlit venues. The part of unlit trading on regulated markets and MTFs is well known, but the trading that happens on an OTC basis remains more opaque. However the best available public sources indicate that this trading might be quite significant when compared with other venue types – and more significant than one would have expected after MiFID, which allowed OTC only as an exception. This has undermined price formation as well as fair competition and proper supervision. She stressed that the same business should be subject to the same rules. FESE thinks the price discovery process should be improved through more rigorous pre- and post-trading transparency for all venues engaged in multilateral trading and a clear definition of OTC to ensure that only truly OTC trades remain outside the trading venue rules. She also stressed that funding for mid-size caps and SMEs should be analysed more closely, as the pan-European trading in blue chips encouraged by MiFID has had the undesirable and unintended effect of restricting the ability of regulated markets to provide access to SMEs. As SMEs are not able to change jurisdiction easily, they will always need access to local capital markets. The MiFID Review needs to take a close look at their needs.

Replying to the question on the need to increase regulation of high frequency traders, Eleanor Jenkins warned against a regulation based on definitions as opposed to a regulation based on effects. Judith Hardt recalled that despite the advantage of high frequency trading in providing liquidity, there is a limit to speed. On the question of the need to maintain the MTF category, David Lester observed that the market needs MTFs because they innovate and they often operate on a pan-European basis, going beyond the national markets that regulated markets were operating in before MiFID. Judith Hardt also observed that it is much more expensive to run a regulated market than a MTF, notably due to different levels of supervisory oversight. If this trend continues, listing fees may have to increase.

Panel IV Investor protection after the crisis – repair or reform

The moderator, Jean-Paul Servais (CBFA) emphasised the great importance of MiFID as a step forward for investor protection across Europe. He recalled the recent contributions of CESR to the review in this area: advice to the Commission, a letter on specific additional areas, and a paper on client classification. He also mentioned some of the topics covered such as inducements, intermediaries' internal approval

process for new services and products. the classification of UCITS as non-complex instruments, and the treatment of different categories of clients.

Fabrice De Marigny (Mazars) noticed that MiFID sets a satisfactory regulatory framework for the distribution of investment products and that fine tuning may be appropriate in few areas such as some aspects of client categorization and information on risk of financial instruments, which should include worst case scenarios. He recalled the PRIPs workstream and welcomed MiFID being the benchmark for selling practices. He emphasised that investor protection is one of five broad policy areas covered by MiFID (besides fragmentation, competition, liquidity and transparency). The five areas are clearly interconnected. For instance, he mentioned best execution as a topic touching upon different areas and deserving attention.

Alain Pithon (AFG) said that portfolio managers are classified by brokers as eligible counterparties and consequently do not enjoy best execution (while they have best execution obligations towards their clients). He recommended a careful assessment of any perceived problems in dealing with the treatment of inducements in the case of portfolio management. He expressed disagreement with positions emerged in CESR as to the classification of UCITS. He said that UCITS are appreciated by retail clients, they are liquid and strictly regulated in terms of management and should remain all classified as non-complex financial instruments.

Guillaume Prache (EuroInvestors) expressed a general pessimistic view since, in spite of the crisis, he sees financial operators back to “business as usual”. He recalled that investor representation at the European financial policies level is an important area in the Commission communication on “Driving European recovery” that has not been followed through yet. He recalled the importance of real - independent - advice and the negative impact of compensation mechanisms on the quality of advice and also said that inducements provisions are actually not enforced. He mentioned the importance of the correct and full implementation and application of the regulatory framework by supervisors. He asked not to delay the PRIPs work stream and emphasised that MiFID only covers a fraction of investment products sold to retail investors.

Bernhard Koch (Raiffeisen Zentralbank Osterreich AG) noted that MiFID was implemented in Member States only at the end of 2007. The implementation was costly and it would be premature to conduct a wide review of the directive. He emphasised that, in assessing investor protection measures, the overall body of legislation should be taken into account, including consumer law and civil law. The overall picture seems satisfactory in terms of protection of investors.

Maria Velentza (European Commission) clarified that the PRIPs work stream is advancing. She mentioned that, for selling practices, it will be part of the MiFID review and, in the case of insurance products, should be included in the parallel review of the Insurance Mediation Directive.

In the subsequent discussion the relevance of distinguishing independent advice was mentioned. It was also noticed that there is an increasing retailization of complex products. Mr Prache recalled the importance of proper financing for investors

associations and mentioned the commitment of the European Commission in that direction. Mr Pithon expressed the hope that US and EU authorities are equally committed to implement any new rules resulting from G20 agreements. Mr De Marigny underlined that the current flexibility of client categorisation rules should remain untouched (opt-in and opt-out mechanisms). He mentioned the impressive budget for investor protection issues in the US, but he also argued that competing US-style agencies do not seem necessary or desirable; rather a dedicated unit in ESMA would be useful.

Panel V Data consolidation – fixing the failures and supporting best execution

Maria Velentza (European Commission) opened the discussion by asking the panellists how they understand the concept of a consolidated tape, if they agree with the idea of a consolidated tape in case of a positive response, if it should be run by a public utility or if they prefer a decentralised solution and if they have any concrete proposals as to how to improve the best execution rule in MiFID.

The moderator, Rhodri Preece (CFA Institute), pointed out that Europe does have problems regarding the timeliness, quality and cost of data. In a survey, 68% of CFA Institute members considered trade-reporting as problematic with 64% believing that the cost of data had increased post-MiFID. 45% of members think that best execution had become more difficult and 82% were in favour of a consolidated tape.

Rudolf Siebel (BVI and EFAMA) considered improvements in data consolidation and quality as one of the main issues of the MiFID Review. He regarded the introduction of Approved Publication Arrangements (APAs) as a necessary first step in that direction, however, he advised to be careful in relation to the creation of a mandatory consolidated tape. A framework should rather be developed in cooperation between CESR and the industry.

Andrew Allwright (Thomson Reuters) blamed problems such as over-reporting, erroneous reporting, the lack of flagging of relevant trades for investors and the high costs on insufficient detail in MiFID on pre- and post-trade transparency rules and a lack of enforcement. In addition, he held the lack of clarity regarding best execution obligations responsible for investment firms not demanding a consolidated tape. He did not agree with the imposition of a mandatory consolidated tape as users wanted customised data rather than a one size fits all approach, it would entail limitation on pricing, would be costly to run and to finance and it would pose significant technical challenges. A demand for a consolidated tape in his view could only be created if investment firms were judged on their performance against the consolidated data.

Charles-Albert Lehalle (Credit Agricole) questioned the possibility of a traceability of execution as the landscape of liquidity changes every two milliseconds. Hence, in his view pre-trade information does not allow for a determined decision and market participants should rely more on post-trade information. As useful regulatory measures he considered a recording of orders for surveillance purposes. For the price formation process, a better quality of post-trade data should be ensured. His conclusion has been that dark pools are not that different from lit pools with so blurred a picture pre trade.

Holger Wohlenberg (Deutsche Börse) emphasised that MiFID should continue without a mandatory consolidated tape as market structures in Europe are different from the US. He advised on harmonising trade-reporting in the EU, the introduction of standards for APAs modelled on those for Trade Data Monitors in the UK, application of sanctions by supervisors and a reduction of delays in reporting. If all that was implemented the industry could develop a solution at competitive prices compared to the US.

In the following discussion Mr Siebel and Mr Allwright considered that there is neither demand nor need for consolidated pre-trade data. Mr Wohlenberg was happy with the existing best execution criteria. Mr Allwright thought that more clarity on the price elements of best execution would be welcome. Dr Lehalle explained that he rejected a mandatory consolidated tape because without a trade through rule it would not have the same importance as in the US.

Conclusions Day 1

Maria Velentza (European Commission) concluded the first day with the following summation.

Panel I: The EU proposals on OTC derivatives, central counterparties and trade repositories goes a long way towards improving the regulation of derivatives markets but the MiFID review has still a big role to play. The G20 commitments must be honoured and trading should be migrated to organised venues as far as possible. In addition, new and harmonised powers for regulators appear to be necessary to introduce an appropriate oversight regime for the derivatives area.

Panel II: Additional rules on transparency in equity and non-equity markets appear to be an essential part of the upcoming MiFID review. Doing nothing in this area cannot be an option after the financial market crisis. However, new regulatory requirements must be carefully calibrated in order not to damage the liquidity of markets. Extensive consultations will be carried out to achieve this goal and we as the Commission encourage all parts of the industry to submit their views. In substance, key areas for review seem to be the aligning and clarifying of the pre-trade waivers regime for shares and defining suitable trade-transparency regimes for other asset classes.

Panel III: Creating more efficient and dynamic markets through competition is one of the key elements of MiFID that must be maintained. Levelling the playing field among trading venues can contribute to that end and should be addressed in the MiFID review. Among the issues to be discussed in the review will certainly be the establishment of appropriate regulatory requirements for crossing systems. Also the impact of and risks associated with high-frequency trading seem to call for a regulatory response.

Panel IV: The protection of investors – retail investors in particular – has been one of the main goals of MiFID. We are aware that the industry had to make significant efforts to adapt to the MiFID requirements. Nonetheless, the financial market crisis has demonstrated that some additional adjustments need to be made. Hence, the

review should aim to strengthen the investor protection rules as well as their enforcement.

Panel V: Given the current state of post-trade transparency data, a regulatory intervention appears to be necessary. Standards in all likelihood need to be implemented to harmonise data outputs and facilitate consolidation. In addition, Ms Velentza saw merit in further exploring the options of mandating a consolidated tape.

DAY 2

Maria Velentza (European Commission) opened the day by recalling the G20 agreement "to improve the regulation, functioning, and transparency of financial and commodity markets to address excessive commodity price volatility". Policy-makers are tasked notably with increasing oversight of commodity and futures markets, as well as related OTC markets, in order to improve their functioning for price discovery and hedging purposes. She noted that there is significant discord around the impact of increased investment flows in commodities and commodity derivatives on prices, and encouraged stakeholders to contribute their views on the required policy actions.

In his keynote speech, Michel Prada (Former Chair, AMF) said that recent developments demonstrate that the proper functioning of commodity derivative markets was at risk. As a result, public authorities and financial regulators had a duty to improve regulation and intensify oversight. Increased investment flows, the presence of new market participants, an increasing number of available derivative products, and the growth of alternative means of trading presented challenges for the existing regulatory framework and for price formation. He emphasised the need to avoid repeating some of the mistakes of the past. No party, instrument, or venue should be overlooked. Transparency and better information flows were critical. The EU should consider a dedicated framework of regulation for commodity markets, with comprehensive but proportionate requirements for all players, instruments, and trading platforms across both physical and financial markets. Supervision of day-to-day market functioning would reside with financial regulators, with various commodity authorities tasked with overseeing market fundamentals and implementing sectoral policy.

Panel I The outlook for global commodity markets

The moderator, Philippe Chalmin (University of Paris Dauphine), started the debate by presenting data showing that commodity markets are undergoing big changes with prices on average three times higher than in 2000. Commodity prices evolution is subject to the combined effects of supply, demand and speculation. Compared to financial products, commodities have a much longer cycle because of physical constraints on the production.

Christof Rühl (BP) said that it was difficult to substantiate that volatility in oil prices is due to speculators. The increase in financial transactions on commodities started before the hike in prices. Long positions in derivatives are said not to have driven prices or inventories up. Oil prices are fundamentally driven by supply and demand and there is a 5 to 6 months gap between the decisions by producers (with OPEC

playing a central role) to increase or decrease output and the actual effect on prices or inventories because of this new production.

Myriam Vander Stichele (SOMO) insisted on the fact that the interests of consumers needed to be taken into consideration in the new regulation. In addition, a precautionary principle and the specific nature of commodity markets in everyday well-being should also be integrated. The new regulation needs to define position limits and the type of intervention allowed as well as increasing the information available to the public and to regulators.

Jorge Montepeque (Platts) said that markets are reacting to fundamentals and fiscal and monetary conditions and that they are efficient. He pointed out that the oil market is getting more global with new pipelines capacities being rolled out and increasingly influenced by the economic evolution of Asia and particularly China.

Jonathan Whitehead (Barclays) mentioned that the fundamentals in the evolution of commodity prices lie with the physical markets. Speculation was said not to impact on prices. Mandatory clearing will make hedging more difficult by requiring hedgers to hold and manage flows of cash. Standardisation has its limits and many products are actually not traded. Transaction reporting obligations and positions limits should be pursued with care to preserve confidentiality while allowing taking large positions for people who need them.

The subsequent discussion and questions from the audience raised various points from the issue of the lack of a clear legal definition of emission allowances to further questions on the exact role of speculation on the commodity markets. Various audience members challenged the assumptions and analysis of those panellists who claimed that the impact of speculation on prices is limited.

Panel II Global regulatory perspectives

The moderator, Don Casturo (Goldman Sachs), introduced the debate by saying that rules should be harmonised across financial and physical markets. Efficient markets require greater transparency to regulators whereas the adequate level of transparency towards the public should be properly analysed.

Wayne Smith (French AMF) recalled that these markets are extremely diverse which create challenges. He made three main recommendations to improve the regulation and oversight of commodity markets: (1) All market participants should be comprehensively regulated and supervised. This implies a narrowing of the MiFID exemptions for specialist commodity firms. Naturally regulators should acquire the necessary expertise to carry out proper oversight of these participants. (2) The G20 roadmap for OTC derivatives should be applied swiftly to commodity derivatives. Promoting trading on exchanges will bring the benefit of increased competition and fairer prices. (3) The transparency of the underlying physical market should be improved. In parallel the cooperation between regulators should be reinforced.

Alexander Justham (UK FSA) acknowledged that no single category of traders could be pointed out as being the main group influencing prices. Against that backdrop he gave the message that there are clear areas where regulation could be improved: (1)

Transparency of trading towards regulators should be improved by implementing the G20 roadmap on OTC derivatives. (2) Market participants should have some regulatory net although proportionate to the risks they pose. (3) Position reporting should be introduced as it is key information for regulators and market participants alike to understand the dynamics of the market. (4) Regulators need a broader set of powers than narrowly defined position limits to tackle excessive price volatility, including powers to address attempts at market manipulation.

Johannes Kindler (Bundesnetzagentur) said that markets need to be better protected by: (i) improving transparency of the trading process, (ii) a proper regulatory coverage of OTC derivatives, and (iii) enhancing the oversight of these markets. The regulatory regime should take into account the whole market, both financial and physical as these markets impact each other. He also drew the attention to the importance of fundamental data transparency.

Sony Kapoor (Re-Define) stressed that commodity markets are fundamentally different from securities markets. Although these markets may not contribute to financial systemic risk, they contribute to food and basic well-being risk. Markets are there to serve genuine end-users, while intermediaries should remain liquidity providers. Investor-interest in commodities is misplaced. Hence he called for the EU to develop a different regulatory approach for commodity markets. Transparency is paramount in these markets as is the idea of positions limits, but these are just the start.

Rich Shilts (CFTC), speaking in a personal capacity, outlined the US regulation of commodity derivative markets and upcoming changes. The CFTC's market surveillance program draws on multiple sources of information among which one of the key tools are the highly confidential data on the activity and positions of individual traders derived from their large trader report system. The Dodd-Frank Act aims to extend the existing CFTC's oversight of exchange traded derivatives to OTC commodity derivatives. It also provides for the setting of position limits on all non-hedged positions for future contracts in physical commodities, including agricultural products, energy and metals with the aims of combating excessive speculation and manipulation, ensuring market liquidity and protecting the markets' price discovery function.

Panel III Users and producers

The moderator, Anthony Belchambers (FOA), introduced the debate by underlying that the role played by speculators in markets has both pros and cons. Pros come in the form of additional liquidity. Cons come in the form of short term price spikes and acceleration of price trends. In light of this, any regulatory intervention will need to be carefully considered and evidence-based. In addition it should be properly tailored to meet the specificities of the commodity markets. A one-size-fits-all approach with rules for banks spilling over to non-banks would be disproportionate. Finally enhancing risk management capabilities of market participants is as critical as building safer derivatives markets.

Yves Vercaemmen (ENI) said that the trading arm of ENI uses commodity derivatives to hedge their commercial and financial risks arising from their underlying physical

activity. As a result their trading activity does not contribute to systemic risk. This is why he stressed the importance of taking the specificities of the commodity business when devising any regulatory rules. He gave the example of the accounting standards (more specifically IAS 32 & 39) as poor practice based on an assumption of "one size fits all". In terms of transparency any additional information made available should be relevant information which allows market participants to better understand the price formation process.

Paul Dawson (RWE) considered the main challenge to be transparency. Regulators do not have up to now the necessary information to understand what is happening in the markets. The forthcoming EU energy transparency and market integrity regime will bring significant benefits. It will consist of three main legs: (i) transparency of fundamental data, (ii) reporting of trades irrespective of where it takes place, and (iii) alignment of the standards for conduct and integrity with the financial markets standards. He did not think action beyond this tailor-made regime was necessary at this stage, saying that neither these markets nor the market participants pose any systemic risk. In addition there is no interaction with retail investors. Hence the case to extend financial regulation to power and gas trading has still to be made. Lastly the focus should be instead on increasing competition in the physical markets. The current triangle of regulation the energy companies are subject to, i.e. financial, energy and competition is in itself a challenge.

Fausto Filice (Cargill) expressed the view that the system that exists today is not broken although it could be improved. The factors for efficient and well functioning futures markets are the following: (i) the size of the underlying cash market, (ii) the liquidity of the futures markets, and (iii) the convergence between the futures contracts and the underlying at the time of delivery. He added that convergence between futures and the underlying cash markets acts as a natural deterrent for long term speculators. With the reform of the Common Agricultural Policy, producers and consumers will have to adapt to the increased volatility in the physical markets. Efficient futures markets can help them to deal with this increased volatility. He was in favour of a certain number of regulatory measures to maintain the efficiency of the markets: (i) regulators and exchanges should fix the convergence problem by, for example, expanding the number of delivery points, (ii) the introduction of position limits for certain categories of market participants, and (iii) increasing transparency by the introduction for example of a US type of Commitment of Traders report.

Pekka Pesonen (COPA COGECA) said the he current reality for farmers and cooperatives of the physical markets has to be taken into account. Farmers are exposed to severe price volatility. Agricultural markets are connected to world markets which expose farmers to foreign exchange volatility. Instability in agricultural markets has repercussions on other EU stakeholders and industrial sectors. A key tool farmers have at their disposal to deal with this volatility and instability is the futures markets. However these markets should respond to the need of greater transparency. Comprehensive transaction reporting should be introduced. Information about the trading activity of different categories of traders should be made available. Farmers should also get direct access to the markets. Transparency would also be greatly enhanced if the EU had its own tool to analyse world supply and demand, improving the consistency and availability of fundamental data about the underlying physical markets.

In the ensuing discussion several questions were raised about the size and profitability of trading activities of large corporate end-users. The panellists concerned said that this financial information is publicly available but that it is very difficult to draw the boundary between hedging and speculative activities. Some transactions may not qualify as hedging transactions under the international accounting standards but still be backed by underlying physical assets. European Flour Millers meanwhile advocated for an exemption in favour of end users from the obligation to report to trade repositories as these deals do not contribute to systemic risk. The importance for the Commission to consult all interested parties as part of its work was also recalled.

Panel IV The road ahead for EU energy and emissions markets

The moderator, Simone Ruiz (IETA), opened the panel by mentioned three priorities in ongoing EU energy and emissions work: (i) securing conditions for businesses to continue to manage their production and carbon-related risks; (ii) adapting new regulatory requirements to the circumstances of the different commodities; (iii) streamlining reporting requirements to regulators.

Simon Smith (Shell) considered that many parts of the G20 derivatives roadmap were unsuited for commodity trading. He recalled the 2008 advice by EU securities and banking regulators that commodity firms do not represent a source of systemic risk. He said that clearing was well-established in various commodity derivative markets, that Basel rules on capital were not adapted to the industry, and that position limits were not helpful. He did agree however that the various transparency developments, for example trade repositories, could help alleviate concerns over excessive speculation and that better data flow on fundamentals should be required in sectoral legislation.

Alexandre Marty (EDF Trading) said that power companies occupy a central role in electricity, gas, coal and emissions markets, where prices are closely interlinked. He underlined various specific features of emissions markets, for example their origin in political decisions, their dematerialised nature, and their high rate of central clearing. He said that more detailed information on fundamentals such as supply and demand of emission allowances would be welcome, and argued that hasty solutions for enhancing oversight and market integrity should be avoided. He mentioned that financial regulators could well play a bigger role in micro-level supervision, with energy regulators monitoring market fundamentals.

Fredrik Voss (Nasdaq OMX) commented that the basic principles for regulating different commodity derivatives should be the same, with sufficient latitude to take into account notably different physical delivery mechanisms. Liquidity in today's EU power and gas market was poor and more trading by new investors was to be welcomed in order to improve economic efficiency and price discovery. A major challenge today was improving competition in the physical market. Levelling the playing field for hedging between exchange-based and OTC instruments was welcome although he was sceptical about mandatory clearing.

Jeremy Elliott (ICAP) said that competition between commodity derivative trading venues was helping efficiency. For example electronic trading and central clearing were well advanced in energy and emissions markets, compared to some other derivative classes. He stressed that the focus today should be on increasing automation and further developing clearing, as well as setting up efficient trade repositories.

In the ensuing discussion, panellists were challenged on why the G20 roadmap on derivatives was inappropriate for commodity derivatives, why position limits shouldn't also apply, and how to ensure a level-playing field between different participants in commodity markets. They commented that position limits had not dampened volatility in the US, that a transparent subsidy constituted a better means of price control, and that all participants in commodity and commodity derivative market should be better identifiable in the future.

Conclusions Day 2

Maria Velentza (European Commission) concluded the final day of the review of MiFID and commodity derivatives by reiterating that measures designed for commodity derivatives markets should and will be an integral part of the MiFID review. She noted the widespread agreement regarding the increasing "financialisation" of commodity derivatives, that the implications of this beyond financial markets (e.g. global food markets) deserved study, and that if necessary, a preventive policy approach may be required. She concluded with the following summation. **Panel I:** Commodity and commodity derivative markets have experienced developments of late that do pose regulatory challenges. The regulators and supervisors responsible for these markets need to strike the right balance when dealing with these challenges to ensure functioning and sound markets. An enhanced cooperation of the various regulators and supervisors involved seems to be key.

Panel II: The message from the G20 is certainly very clear that action must be taken to tackle the volatility we experienced in commodity markets. Of course, the Commission will respond to this message swiftly and take appropriate regulatory action. We have a number of initiatives in the pipeline which will apply to commodity derivatives markets in particular. In the field of DG Markt Ms Velentza noted in particular the EMIR legislation, the PRIIPS initiative and the reviews of MiFID and of the Market Abuse Directive.

Panel III: The European Commission is aware that commodity derivatives markets function to some extent in a different fashion from equity markets, therefore, solutions must be found that fit the characteristics of these markets. To that end Ms Velentza found the ideas and opinions expressed during the course of the day very helpful and said that the Commission is keen to continue the dialogue with all stakeholders also in the future.

Panel IV: Energy and emissions markets are also very specific in their functioning and the development of "tailor-made" regulatory solutions for these markets should be explored. For example, the emissions markets have a significant number of SME participants who need to fulfil their obligations in respect of submitting CO2

allowances. Imposing a wide array of the financial markets regulation upon them does not appear to be proportionate. However, market integrity needs to be upheld at all times. In so far as necessary, adequate supervisory tools should be developed to guarantee market conditions that benefit the European economy as a whole.