

MiFID Review

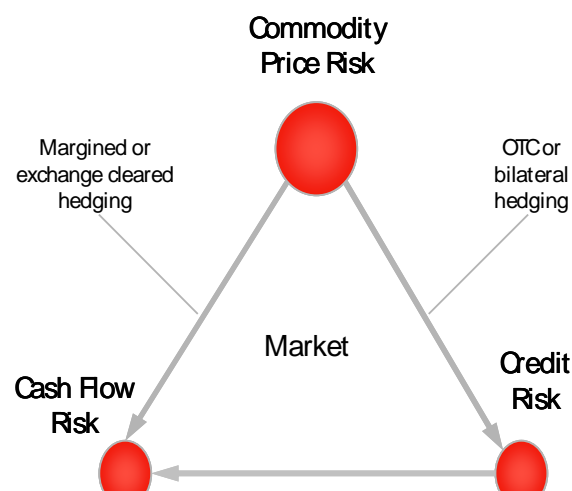
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1. Introduction

Energy trading is important to ensure that large consumers and producers can hedge their underlying business to avoid being exposed to short term volatility, and to allow retailers to hedge and thus manage the price volatility risk on behalf of end consumers. Developing liquid electricity and gas markets is an important European policy that will increase competition and ensure competitive prices for end consumers. Regulation on possible mandatory exchange trading or electronic trading should consider the specific needs of asset based commodity traders that hedge their underlying business. Policy should be compatible with the need for liquid energy markets. There are regulations in place which cover energy trading and the Commission (DG ENER) proposes to introduce a tailor-made regulation to increase transparency and market integrity. E.ON supports this approach, which should lead to proportionate regulation.

2. Risk management

The energy industry is extremely capital intensive and investments in assets such as power plants give rise to commodity risk exposures. This is managed within a strict framework including credit risk limits, cash flow risk limits and commodity price risk limits. In doing so, the price risk, credit risk and cash-flow risk have to be managed in an integrated way; a focus on credit risk only would be at the expense of either cash-flow risk or price risk. As an end user of derivatives, E.ON has strict credit policies in place to ensure that credit risk is maintained at an acceptable level. The risks are managed in the market by an optimised mix of exchange trading, OTC derivatives and physical contracts. For example, the commodity price risk of a coal fired power plant is hedged by selling electricity and buying coal and emission allowances in the forward market.



In cases where the trade is cleared at a clearing house, there is an obligation to post cash to a margining account. As market prices change, the cash needed for margining will also change, which causes a cash-flow risk while the underlying business does not have any opposite cash-flow effect until fulfilment, which could potentially occur in several years time. On the other hand, in cases where the trade is done without clearing, there will be a credit risk that has to be managed. In many cases there are bilateral credit arrangements for trades that are not centrally cleared. These hedging activities are done as part of the main business to ensure that there is sufficient cash flow to match the ambitious investment programme.

3. MiFID Review

More exchange-based and electronic trading shall be achieved in a competitive environment by offering attractive markets when it comes to liquidity, transparency, fees and clearing arrangements to the benefit of those using the services. It is, however, important to keep other options open to ensure that firms are able to trade in a way that is suitable for serving justified hedging needs for standard and non-standard products.

Obligatory exchange-based or electronic trading should be avoided. A large number of market participants in energy markets trade small volumes and bilateral trading is frequently the most efficient option. Many European gas and electricity markets are not yet developed and the liquidity in many derivatives markets is low. It is important that non-financial firms have the ability to choose the most efficient way to optimise price risk, counterparty risk and cash liquidity risk. Transparency would be achieved by publishing all standardised OTC derivatives contracts anonymously and reporting to trade repositories. The most efficient way is for exchanges and brokers to report to trade repositories. Pure bilateral standardised contracts should be reported by the counterparties themselves.

The venues that are considered to be exchanges or MTFs by today's definition should be considered organised venues. Brokers should be seen purely as facilitators of bilateral trading.

Product definitions should be aligned with US legislation where the term "swap" does not include any contract of sale of a commodity for future delivery (or option on such a contract).



The current MiFID exemption for energy traders that deal in financial instruments on their own account should remain, as they pose only minimal systemic risk.