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German Association of Energy and Water Industries (BDEW)
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European Central Bank,
Secretariat Division,
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DRAFT RECOMMENDATIONS FOR CENTRAL COUNTERPARTIES REVISED FOR CCPs CLEARING OTC DERIVATIVES

**German Association of Energy and
Water Industries (BDEW)**
Reinhardtstraße 32
10115 Berlin · Germany

Dear Madam, dear Sir,

the German Association of Energy and Water Industries (BDEW) represents more than 1,800 members of the electricity, gas and water industry. In the energy sector, we represent companies active in generation, trading, transmission, distribution and retail.

BDEW
General Executive Managers
Members of the Board of Directors
Dr. Eberhard Meller
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We are grateful for the opportunity to comment on the Draft Recommendations for Central Counterparties revised for CCPs clearing OTC derivatives. We generally believe that these recommendations are a useful definition for central counterparties and provide an adequate framework for the further development of the use of clearing. Also, using CCPs for clearing derivatives is a tool that can provide more stability in the market for credit derivatives.

In adjusting the recommendations, we agree very much with the focus being on credit derivatives as posing a risk to financial stability. However, we are concerned that the paper does not differentiate between the different underlyings of derivatives, namely between financial instruments as underlying (e.g. a credit as underlying of a credit derivative) of financial derivatives, and commodities as underlying of commodity derivatives. Commodity derivatives serve a fundamentally different purpose than purely financial derivatives. Especially in the energy market, commodity derivatives are used to a large extent for risk management purposes and

to provide flexibility in physical supply contracts that could otherwise not be captured. This optionality is essential for stabilising energy prices.

In our view, the recommendations should therefore be confined to the use of CCPs in the market for financial derivatives.

Against this backdrop, we would like to highlight specific issues in the proposal, which are vague in their description, but may have a potentially negative impact on risk management practises of commodity traders and the energy market in general. In particular, the following recommendations would benefit from further clarifications in the light of our comments:

Legal framework is required for CCPs

In Recommendation 2 concerning the legal framework, it is very unclear what exactly would be requested. The European energy market is supervised by energy regulators like BNetzA and CRE, and only where energy companies undertake financial services that actually require a licence under MiFID provisions, it is banking regulators' rules that apply.

Generally, wholesale energy markets are already subject to a significant set of energy-specific legislation. This includes, besides others, the Directive 2003/54/EC and Regulation 1228/2003/EC for electricity and the Directive 2003/55/EC and Regulation 1775/2005/EC for gas in particular, as they set the legal framework for the internal energy market. In reference to these legal foundations a harmonised approach of implementation and supervision is vital to avoid distortions for energy wholesale trading, be it national or cross-border.

Thus, power and gas markets shall predominantly be governed by this set of specific energy market regulations (and supervised by the respective energy regulators), but not by additional financial market regulation, which might even contradict the existing set of rules. Probably the most important challenge of the current EU legislative framework is to define the appropriate borderline between financial market regulation and the regulation of the physical energy markets and – if there is an interface – to find appropriate measures to deal with it.

Thus, there is no need to apply rules designed for the financial market to the energy market, especially as they are by nature inadequate to fit the specific requirements of energy markets.

Participation Requirements for CCPs

We see another ambiguity in Recommendation 3, where participation requirements are defined. Especially with rules that describe generally applicable principles, it is misleading, if, for example, a power generation company would be required to fit a framework designed for banks and investment funds.

Especially in the light of current political initiatives (e.g. German Steinmeier/ Steinbrück paper, the Petersen Bill, the Harkin Bill etc.) we are concerned that these recommendations might be used as a step towards regulating derivatives per se (financial and commodity) by requiring all trading being conducted via a CCP which in turn would further require the standardisation of all derivatives.

Therefore, we would welcome a specification that makes clear that regulatory provisions for financial market participants cannot be applied to energy market participants on a one to one basis.

Commodity derivatives need to be tailor-made

The idea to simplify and standardise OTC derivatives might be desirable for financial markets. However, in energy markets we do not see a need for this, with the most “complex” derivatives being found in supply contracts of municipal utilities and suppliers without own generation capacities. These instruments derive out of optionality contained in physical contracts used to offer the required flexibility for the buyer to react to changes in demand. Any effort to apply such standardisation proposals to the energy market would lead to a discrimination of especially smaller participants in the energy markets and would not meet the actual needs of the respective counterparty.

Commodity derivatives cannot all be traded via a CCP

The mentioned political initiatives also propose the mandatory use of clearing houses for all derivatives regardless of their purpose and nature.

We do not see the need to make a clearing house mandatory for the energy market. Activities in energy trading do not imply the same financial

systemic risk as activities in the “classic” financial markets. The main purpose of a clearing house is to diminish the effects of a counterparty failure. Energy companies already monitor and manage credit risks actively, and thus we do not see counterparty failure as an immediate danger. The energy trading market is a purely professional market with only sophisticated participants. Unlike the financial market, an insolvency which might occur in the energy market, will not have a major impact on other energy companies. The outcome of the failure of Lehman Bros, then an active participant in the energy trading market, showed the effectiveness of the highly professional risk management and proved that there are no risks of contagion present, even if a major energy market participant would fail.

We would like to point out that most power exchanges already offer central clearing services. Thus, additional mandatory structures would only cause additional costs which will have to be passed on to consumers. There are also already rigid requirements that participants have to abide to. We do fear that any enforced requirement to use a central counterparty would result in reduced participation of particularly smaller participants in the market, which could lead to less liquidity and competition.

Therefore, we would strongly recommend making clear in these recommendations that any regulation must take into account the different nature of commodity derivatives and treat them separately. Credit derivatives, which are at the centre of the debate and the focus of the draft recommendations, are very different from commodity derivatives. This clarification of the difference also applies to central counterparties, which might be used in the commodity business.

Commodity derivative trading by energy companies is mostly done on own account for risk management and hedging purposes. While the production of the generation companies is sold to the market on a forward basis, supply companies need to purchase electricity on the market to supply their customers. For all energy companies derivatives are tools to optimise their physical portfolio. Thus, trading of energy (including derivative products) is, most commonly, used to mitigate arising price and volume risks.

Therefore, we would like to express our support for the recommendations as a framework for CCPs in the financial market. At the same time, we would like to highlight, though, that a differentiation between commodity

derivatives and financial instruments is essential to avoid that financial regulation will subsequently distort basic processes in the energy markets.

If you have any questions concerning the foregoing please do not hesitate to contact my colleague Marcel Steinbach (marcel.steinbach@bdeu.de) or myself.

Yours sincerely,



Dr. Michael Wunnerlich