



Lars Jul Overby
Head of Credit, Market and Operational Risk Policy
Unit
European Banking Authority
One Canada Square
Canary Wharf
London E14 5AA
United Kingdom

Markets Regulation

Your ref.
Your letter
Our ref. KPH/sgo
Contact Dr. Karl-Peter Horstmann
Phone +49 201 5179 1204
Fax +49 201 5179 4163
Email karl-peter.horstmann
@rwe.com

02 February 2017

RE: RWE response to the Discussion Paper on a new prudential regime for investment firms

Dear Mr. Overby,

I am writing to you on behalf of RWE Supply and Trading GmbH (**RWE**) and regarding the Discussion Paper "Designing a new prudential regime for investment firms" [EBA/DP/2016/02]. RWE welcomes the opportunity to provide comments on the Discussion Paper, to which we have replied in detail today through the EBA website. We support the development of an efficient legislative and regulatory environment that recognises the unique characteristics of the energy trading sector. In this letter we wish to bring to your attention our general concerns regarding the proposed regime and to provide an overview of the RWE position.

RWE is the interface between the RWE Group's operating companies and the global trading markets for energy and energy-related commodities as well as the hub for all tradable commodities, in both their physical and/or derivative forms. This includes power, gas, coal, freight, oil, weather derivatives, biomass, emissions certificates and renewable energies. RWE is responsible for the economic optimisation of power generation and the entire gas business of the RWE Group, including all procurement, storage and LNG-related activities. Large industrial companies and trading partners are offered long-term energy delivery concepts and portfolio management with regard to physically delivered commodities.

Definition of Commodities Dealers to reflect relevant activity

RWE has an affiliate authorised as investment firm under the provisions of Directive 2004/39/EC (**MiFID**) and which qualifies as "Commodities Dealer" within the meaning of Articles 493(1) and 498(1) of Regulation (EU) 575/2013 (**CRR**). As Commodities Dealer we currently benefit from derogations to Part III CRR (own funds) and Part IV CRR (large exposures) requirements set out in Articles 493 and 498 CRR. These derogations are due to expire on 31 December 2020. It is therefore of crucial importance to RWE to participate in the ongoing debate on the future prudential regime for investment firms generally, and Commodities Dealers in particular.

We believe that any new prudential regime should review the Commodities Dealers definition. The current definition excludes investment firms authorised on or before 31 December 2006 and such investment firms do not benefit from the own funds and large exposures derogations. We believe that the definition should be based upon activity undertaken by an investment firm, regardless of the date on which this activity commenced. A new definition should also extend the list of permitted financial instruments to include emission allowances under MiFID II Annex I Section C(11). Such an updated definition would ensure the consistent and fair application of relevant prudential requirements.

RWE Supply & Trading GmbH

Altenessener Str. 27
45141 Essen

T +49 201 12-09
F +49 201 5179-4040
I www.rwe.com

Aufsichtsrat:
Dr. Rolf Martin Schmitz
(Vorsitzender)

Geschäftsführung:
Dr. Markus Krebber
(Vorsitzender)
Tom Glover
Peter Krembel
Dr. Michael Müller
Andree Stracke

Sitz der Gesellschaft: Essen
Eingetragen beim
Amtsgericht Essen
Handelsregister-Nr.
HRB 14 327

Deutsche Bank Essen
BLZ 360 700 50
Kto.-Nr. 299 070 300
SWIFT: DEUTDEDE
IBAN: DE68 3607 0050 0299
0703 00

Ust.-IdNr. DE 8130 22 070
Ust.-Nr. 112/5717/1032

Need for an evidence-based approach

We wish to reiterate our fundament opposition to the introduction of prudential requirements for Commodities Dealers without a proper assessment of the risk profiles of these investment firms. We note the European Commission's mandate to review the application of both Articles 493 and 498 CRR to Commodities Dealers and, potentially, to propose a new prudential regime applicable to such firms. While we acknowledge the Commission's mandate, we do not agree that a new prudential regime is required or justifiable in the commodities sector. We believe that the current derogations have served European power and gas markets well and we are concerned that the ongoing Article 508 CRR review may become a purely policy-driven process.

Limited impact of Commodities Dealers on financial markets

As we discuss in more detail throughout our response to the Discussion Paper, we consider the risk posed by Commodities Dealers to financial markets to be in no way comparable to the systemic risk posed by credit institutions and systemically important investment firms. Back in 2008 the predecessors to the EBA and ESMA concluded that *"the application of the CRD requirements (including the large exposures regime) to specialist commodity derivatives firms would be disproportionate and would lead to regulatory failure"*.¹ We are confident that nothing has changed in commodity derivatives markets since to challenge this assessment. Most recently, data published by the Bank for International Settlements (**BIS**) shows that commodity derivatives remain the smallest segment of over-the-counter (**OTC**) derivatives markets, accounting for 2% of notional amounts outstanding and 4% of gross market value in mid-2016.² The European Central Bank (**ECB**) concludes in its 2016 opinion on the proposed extension of the application of the Articles 493 and 498 CRR exemption, that Commodities Dealers are significantly less leveraged than their financial counterparts, have a more resilient capital structures than banks, maintain low asset-to-equity ratios, do not engage in bank-like maturity and liquidity transformation and have limited linkages with the broader financial markets.³

Potential risks that Commodities Dealers may pose to their counterparties, their markets and themselves are efficiently managed by prevailing risk management functions and compliance with existing European Union legislation. This includes Regulation (EU) 648/2012 (**EMIR**) and its requirements that financial counterparties (including Commodities Dealers) centrally clear eligible OTC derivative transactions, exchange margin for non-cleared OTC transactions and report transactions in OTC and exchange-traded derivatives (**ETDs**). In addition, wholesale energy trading firms are subject to REMIT rules on transparency and market integrity. All market participants are subject to stringent MAR requirements and sanctions regarding the prevention of market abuse and manipulation. Finally, both MiFID authorised and non-authorised firms will be subject to the MiFID II regime on position limits and reporting for commodity derivatives.

We believe that simply the size of a firm's business should not be a predetermining factor for the assessment of a firm's risk profile. In contrast to financial firms, commodities market participants are not interconnected and their financial market exposures are largely backed up by physical assets. The current exemption from Articles 493 and 498 CRR has

¹ CESR / CEBS's technical advice to the European Commission on the review of commodities business [CESR/08-752], 15 October 2008. The analysis goes on to state that *"Regulation brings net economic benefits only where it addresses potential market failures. The arguments for extending CRD may not take fully into account the particularities of specialist commodity derivatives firms, including the fact that [...] the systemic risks arising from specialist commodity derivatives firms appear to be lower than those stemming from credit institutions and ISD investment firms."* (see para. 75, p. 26).

² Bank for International Settlements, Statistical release: OTC derivatives statistics at end-June 2016.

³ European Central Bank, Opinion of the European Central Bank of 3 March 2016 on a proposal for a regulation amending Regulation (EU) No 575/2013 as regards exemptions for commodity dealers (CON/2016/10).

been in existence for over 10 years and during this period nothing has occurred to call into question the rationale for establishing or maintaining the exemption.⁴

In addition, as European legislators are entering the review phase of the post-crisis legislation, it becomes apparent that some of the regulatory and legislative measures currently in place will need to be simplified and re-adjusted. For instance, in its recently published report on the implementation of EMIR the European Commission confirms that work needs to be focused on determining "how to alleviate the challenges identified to allow for a streamlined application of EMIR that could remove excessive regulatory burdens on market participants and enable smoother implementation of the requirements". Adoption of a new stringent prudential regime for Commodities Dealers would run counter to this approach.

Potential new prudential regime to reflect unique characteristics of Commodities Dealers

Nevertheless, in order to facilitate further discussion we include in our response views on the proposed elements of a potential new prudential regime for investment firms as proposed by the EBA. We would like to note, however, that despite the EBA's mandate from the Commission to provide technical advice in respect of investment firms *and* Commodities Dealers, the Discussion Paper, and proposals thereof, are limited in application to the commodities sector. Contrary to the EBA's own recommendations, included in its December 2015 report on investment firms that indicators related to systemic importance should replace the list of investment services and activities for the purpose of prudential categorisation, the Discussion Paper stops short of making those proposals.⁵ In addition, we believe that any analysis that is presented for discussion should be evidence-based. Unfortunately, no data gathering exercise has been completed in time to provide the required evidence.

We are of the opinion that until now Commodities Dealers have not been given due consideration in the course of this review, which is reflected by deficiencies in the current Discussion Paper. We would therefore welcome another opportunity to have a discussion with the EBA and with the Commission once the data gathering exercise is completed and the data received has been properly analysed. We fear that without an understanding of the entire context in which Commodities Dealers operate, the conclusions of the review may be flawed.

In our view, any potential prudential regime would have to be sufficiently tailored in order to reflect the unique characteristics of Commodities Dealers. We are of the opinion that for any such prudential regime to be truly risk-based, it needs to clearly differentiate between systemic and non-systemic investment firms. To this end, we propose in our response a slightly modified classification based on four categories. We agree therefore that Class 1 should be reserved for a small sub-section of the biggest, systemic and bank-like investment firms (G-SIIs and O-SIIs). We suggest, however, that Class 2 should be carved out specifically to cover other systemic (but not bank-like) firms. The new Class 3 should cover firms that are not-systemic, including Commodities Dealers. Finally, Class 4 should cover small, not-interconnected firms.

⁴ *Ibid.* point 1.3 (p. 2): "despite the considerable growth of the commodity derivatives markets over the past 15 years, there is no conclusive evidence that commodity derivatives trading has adverse effects on the wider financial system".

⁵ European Banking Authority, Report on Investment Firms: Response to the Commission's Call For Advice of December 2014 (EBA/Op/2015/20) [link]. See Recommendation 1: "[...] The future categorisation of investment firms under the CRD IV should, then, be achieved with reference to the systemic importance of the investment firm or its ability to run 'bank-like' activities, expressed through consistent indicators, both qualitative and quantitative; this would lead to a clear cut in the population of investment firms within the EU. Indeed, a key tool for amending the current complex regime, which establishes rules that apply differently depending on the category to which the firm belongs, could be reducing the number of 'categories' and simplifying the regime by establishing greater use of proportionality, both upstream (strengthening rules for those firms that are deemed to pose more risks to financial stability) and downstream (simplifying requirements for the majority). [...]"

Page 4

Any prudential regime for non-systemic firms should be based on *gone concern* basis, as opposed to *going concern* that is suitable for systemic firms. The primary focus of the regime for (new) Class 3 firms should therefore be orderly winding-down. We believe that both (new) Class 3 and Class 4 should be subject only to fixed overheads requirements (FOR) due to their non-systemic nature. In our response we provide additional arguments on the necessary adjustments to the criteria determining (new) Class 3 in order to make it adaptable to Commodities Dealers.

I remain at your disposal should you or your colleagues like to discuss in more detail.

Sincerely,

signed by Karl-Peter Horstmann

- Dr. Karl-Peter Horstmann -
Head of Markets Regulation
RWE Supply and Trading GmbH