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## M E M O R A N D U M

**TO:** CFRC Working Group  
**FROM:** Emmanuelle Sebton  
**DATE:** 28<sup>th</sup> March 2006  
**RE:** **CFRC Working Group meeting of Friday 10 March 3-5pm**

### **1- Update on meeting with the European Commission of 30 January**

Martin Spanier, Anthony Belchambers and Emmanuelle Sebton met with Peter Smith and Giuseppe Siani (DG Internal Market- EU Commission) on 30 January to discuss the article 45d review.

Peter told us that the Commission would report back to the European Banking Committee on their work plan at the end of March. They will mandate the Committee of European Banking Supervisors to conduct a review of current regulatory practices in the area of commodity trading, including an analysis of the national supervisory regimes currently in place in the EU to address the risks arising from commodities business and commodities firms, and an assessment of relevant non EU supervisory regimes seeking to address similar risks. The mandate will also include fundamental analysis of the risks arising from the conduct of commodities business, including how these risks may differ from those addressed by the prudential regime set out in the CRD.

The Commission had received our letter of end January and agreed on the crucial need for an assessment of the purpose of prudential regulation in the case of commodity firms. They however also expected level playing field concerns to be raised by investment firms regulated under the CRD and competing with the trading arms of commodity firms.

The time line for CEBS' survey work would be from April till June; the Commission hinted that we would probably see a draft of the supervisory practices survey before it was finalized.

The Commission will formally respond to our letter once CEBS have performed their analysis, i.e. probably not before the summer.

### **2- Nomination of a commodity firm representative on the CEBS Consultative Panel**

When CEBS is officially mandated to conduct the survey mentioned above, they will have an incentive to invite a commodity firm on their Consultative Panel. ISDA has just recently nominated an investment firm on the Panel at CEBS' request, and has expressed an interest in

nominating a commodity firm in due course. Jan Peter Onstwedder from BP has agreed to sit on the panel should the opportunity arise.

**Action : ISDA to contact the Secretariat of CEBS once they have been mandated by the Commission**

### **3- Position of investment banks re CFRC work agenda**

Anthony Belchambers referred to his email (27.02.06) which set out FOA's reasons as to why the question of investment bank engagement should be discussed by the CFRC WG. He reported on a meeting between LIBA, FOA and ISDA at which it was suggested and agreed that, once the CFRC WG had crystallised its position, completed its analysis and drafted its report, ISDA/FOA would discuss the CRFC report in draft form with their investment bank members and LIBA before any disclosure to the Commission or any regulatory authorities.

The CFRC WG confirmed that there should be no direct participation of any investment bank on the group. However, members did recognise the risk of alienation and the potential of counter-lobbying from the investment banks. Emmanuelle Sebton and Anthony Belchambers agreed, but the latter was more optimistic and felt that there would be recognition of the need for regulatory proportionality and referred to the development the OMP/EMP regime as an example in point. He added that even the CFRC WG's proposals for a revised regime would result, in any event, in a more conservative prudential regime than currently applied in the UK. The CFRC WG agreed the position suggested to LIBA and that there should be disclosure of the position being taken by them, but only when it was in near final form.

Emmanuelle Sebton gave a presentation to the Financial Regulation Committee of LIBA on 7<sup>th</sup> March. Only two firms (Credit Suisse and JPMorgan) were in attendance. The slides were circulated to the wider LIBA membership for their information. But the issue clearly is not yet on the radar screens. Gillan Hood from HMT, who attended the FinReg presentation, is planning to create a forum where commodity firms and investment firms will have an opportunity to discuss regulatory capital matters, in an attempt to avoid a breakdown of communication between the two groups of firms later on in the year.

### **4- Progress report on credit/market risk**

The credit risk expert group has made good progress, although the revision of the SM parameters is not finalised (power and gas data are needed) yet. Further discussions are to be held by the end of March to address:

- the influence of price seasonality on the risk measure used in the IMM framework;
- the size of the beta factor in the SM;
- the CCR capital treatment of unsettled transactions.

Firms are invited to send the ISDA part of the KPMG questionnaire back to ISDA as soon as possible.

The market risk expert group is also progressing quickly (see slides attached). Again, further data is required on power/gas underlyings. The question of whether running a hypothetical portfolio test would be useful was posed to the group. RWE and EON have already run such a test on a limited portfolio. It was agreed that the market risk expert group should hold a specific call on portfolio testing, based on detailed information on the composition of the RWE-EON portfolio. Objectives of this call would include:

- expanding the RWE-EON portfolio if necessary; creating sub-portfolios per broad commodity type [energy separately from metals] Note that a metals portfolio is already available;
- discussing the desirability of expanding the portfolio testing to cover both market and credit risk;
- discussing the feasibility and desirability of hiring an outside consultant to run the capital calculations on the various sub-portfolios, in different price scenarios (contango and backwardation)

On operational risk firms were of the view that the capital treatment should either be expenditure based or the Basic Indicator Approach. **FOA to take forward.**

#### **5- Pillar 2 Expert Group**

The Pillar 2 Expert Group will gather on a conference call in the week of 20 March. It is crucial that as many firms as possible join the expert group.

Separately, it was noted that for the time being Large Exposures are not addressed in any of the established expert groups.

**Action : ISDA to identify a “home” for the large exposures issue.**

#### **6- BaFin and FSA consultations on the implementation of articles 45a and 45d of the CAD**

In Germany, a group of commodity firms is currently addressing the shortcomings of BaFin's implementation of the articles :

- emissions and weather are not exempt from the large exposure rules;
- energy firms licensed under the KWG [which is distinct from the ISD] on 31/12/06 are not exempt from the CRD.

In the UK, the FSA is essentially proposing to implement articles 45a and 45d in full and to continue to apply to commodity firms the capital regime they are currently subject to. The FSA is asking whether, for firms acting as arrangers or EMPS, a principles based capital regime may make more sense than detailed rules.

**Action: the CFRC will not comment on the questions posed in the FSA CP 06/3, but members will seek clarification of certain points from the FSA at the next COMSG meeting.**

**7- AOB**

ISDA is holding an Energy conference on April 7<sup>th</sup>, where the Commission will provide an update on its work plan. If interested, please register on our website ([www.isda.org](http://www.isda.org)).