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M E M O R A N D U M

TO: CFRC Working Group
FROM: Simon Andrews
DATE: 21st July 2006
RE: Notes of CFRC Working Group meeting of Friday 14th July 12-5pm

The Working Group received updates on the work being undertaken by the various sub groups.

1 – Interaction between MiFID and CRD reviews

The position regarding the MiFID exemptions review and the CRD was outlined. If the MiFID review determines that commodities firms fall outside the scope of MiFID then no EU wide CRD 48(2) treatment will apply, and firms will be subject to regional regulation as relevant. If the activities of commodities firms are deemed to fall within the scope of MiFID then the CFRC Working Group will continue to make the case for either the recalibrated or alternative approach.

A copy of the Clifford Chance memo entitled “Commodity Derivatives Working Group – MiFID commodity exemptions review” was distributed to members of the Working Group (attached again for convenience).

The memo argues that the burden of proof for imposing new legislation on commodities firms lies with the Commission and not with the industry, and that a CBA should be undertaken by the Commission as part of the consideration process. The memo further argues that, in the event that the Commission cannot prove a case for industry wide legislation, it must necessarily enforce an industry wide exemption so as to prevent the imposition of different regional treatment by individual regulators. Such a varied regime would be counter to the intention of the Commission to promote growth and diversity in the industry.

A Quebec paper on the licensing of commodities firms was cited as an informative paper for those who wished to further understand the issues and arguments (attached).

The potential for the MiFID review to render the work undertaken by the sub groups on the recalibrated and alternative approaches irrelevant in the event that the review found the industry to be outside the scope of MiFID gave rise to a discussion on the timing of the release of the Working Group’s reports to CEBS. The possibility was raised that release of either the recalibration or alternative approach papers might lead the Level 3 Committees into following that path rather than giving full consideration to the MiFID review.

It was agreed that the Working Group would not be averse to letting CEBS know the general direction of our work, but that no papers would be released without the agreement of the Working Group, to be obtained nearer the time of release when the position of CESR and CEBS was clearer. Until such time, the original timeframe would be followed.

2 – CEBS Update

It was noted that the Commission has asked CEBS to undertake two surveys, one into the state of current regulation in the industry, and the other into the state of the market.

The regulation survey is to be undertaken by October 2006, while the market survey is not due until April 2007. However these dates are not final and it is possible that the deadline of December 2006 will be set for both surveys.

a. Questionnaires

The Working Group has been approached by CEBS for feedback on questionnaires relating to these surveys by 20 July.

It was noted by several members of the Working Group that the questions contained within the questionnaires could give a misleading impression of the industry. It was therefore agreed that the Working Group would provide feedback and suggest alternative questions to CEBS by the deadline date.

It was agreed that particular attention should be paid to the distinction between group wide controls, which were currently considered adequate, and entity specific controls which might currently be less developed in firms and would prove costly to implement. The questionnaire did not make such a distinction and it was felt that a failure to do so would result in an inaccurate portrayal of the control environment within the industry.

Action - Working Group to provide detailed feedback on the questionnaires by no later than 17 July. ISDA to collate the responses and draft amended questionnaire.

Members of the Working Group were concerned that the results of the survey might not be made public or that they could be used by the FSA to undercut the work of the Working Group. It was noted that the FSA appeared generally sympathetic to the aims of the Working Group as regards capital treatment, and as such this was unlikely. It was further noted that several members of the Working Group were also members of the FSA COMSG at which the results of the surveys were likely to be discussed, allowing the Working Group to monitor the FSA response.

b. Industry expert working group

CEBS intends to set up a commodities industry expert working group to assist with its review and the Working Group has been approached through the trade associations to provide a list of potential members for this group.

Although some volunteers have already put their names forward, the Working Group agreed that the final list needed to be more balanced and should include representatives from metals firms and French firms.

Action - Alistair Rapley to liaise with members from other metals firms and agree a nominee. Gaselys to confirm their participation.

It was noted that the proposed working group did not include any law firms and the suggestion was made that any list should include at least one member with legal experience and knowledge of MiFID if possible. Karl-Peter Horstmann (RWE) agreed to play that role.

3 – Recalibrated Pillar 1 Update

The Working Group reviewed the latest draft of the Recalibrated Pillar 1 report.

a. Credit risk

A copy of the latest composite memo on credit risk was circulated and reviewed. No further points were raised. It was noted that ISDA has hired Ernst & Young to review the spreadsheets and that Chris Bates (Clifford Chance) will edit the memo. This part of the report should be finalised by early September.

b. Market risk

The Working Group noted that further discussion was required on the proposed methods of recalibration for Market Risk. It was agreed that these options would be discussed in advance of the next meeting of the Working Group

Action – sub group to discuss Market Risk recalibration options in a conference call to be held in the last week of July.

c. Operational risk

The Working Group briefly reviewed the first draft of the Operational Risk section of the report drafted by the FOA. The FOA noted that this draft made some assumptions regarding group consensus opinion on the basis of discussions at previous meetings of the Working Group and requested feedback from members of the Working Group who did not feel that the opinions expressed represented Group consensus.

It was agreed that further review of the section would be undertaken by the Operational Risk sub-group.

Action – sub group to discuss report section further in conference call (to be arranged by Simon Andrews).

4 – Alternative Approach Update

The Working group reviewed the alternative approach and the arguments supporting it as presented in the executive summary to the latest draft Alternative Approach report, and the memo distributed in advance of the meeting.

The Alternative Approach recommends zero weighting to Pillar 1 and a revised Pillar 2/ Pillar 3 framework.

The Working Group agreed with the outline of the Alternative Approach as presented, but decided to postpone final approval pending the production of a more detailed outline of the implications of this Approach.

Action – Hamilton Hinds (BP) and Joerg Sperling (RWE) to produce more detailed summary of changes between the existing CRD and the proposed Alternative Approach for Working Group to review at the next CFRC WG meeting.

It was noted that the existing CRD was too closely tied to the notion of regulatory capital to allow non capital sections for the report to stand as written once capital requirements were removed. It was therefore agreed that the directive, and in particular Pillar 2, would need significant redrafting as part of the Alternative Approach.

The Working Group agreed that time restrictions required that the this work be conducted by a third party, and it was proposed that Emmanuelle Sebtou and Hamilton Hinds approach Patricia Jackson (Ernst & Young) for a quote in the absence of a viable alternative suggestion.

Action – members of the Working group to consider potential alternatives and provide names to Emmanuelle Sebtou by end of July.

It was agreed in principle that the trade associations would raise funds to pay for this work from members, although the details of any fund raising would not be discussed until the likely cost of the work was known. It was noted that neither ISDA nor FOA had sufficient unallocated cash to pay for the work without additional support from member firms.

The Working Group noted that much of the input for the Alternative Approach had come from larger firms and it was agreed that input from smaller firms was needed if the final report was to take the interests of all sizes of commodity firm into account.

5 – KPMG Report

Gregory Salter (KPMG) advised the Working group that the report commissioned by the FOA was awaiting final FOA review and participant release agreement before it would be available to the Working Group.

KPMG summarised the approach and findings of the report and noted that the evidence agreed with the view of the Working group that the CRD as written was not directly compatible with the structure of industry participants and current market practice.

It was agreed that the final report would be considered along side the Recalibration and Alternative Approach reports produced by the Working Group to ensure consistency of message.

C F R C
ISDA, One New Change, 2nd floor
Fri 14th July 2006, 12.00 – 5.00pm
A=Attend, C=Calling in

Name	Company	Attend
Emily Harman	Accord Energy	A
Ronnie Ballak	Accord Energy	A
Alistair Rapley	Amalgamated Metals Trading Ltd	A
Hamilton Hinds	BP	A
Jan-Peter Onstwedder	BP	A
Chris Bates	Clifford Chance	A
Tobias Strothmann	ConEnergy	A
Emma Culley	ConocoPhillips	A
Dawn Bell	EDF Trading	A
Martin Spanier	EFET - Syneco	C
Vincent Mohy	Electrabel	A
Bernd Kaelber	EON	A
Jane Green	FOA	A (3.30 – 4.00)
Simon Andrews	FOA	A (3.30 – 4.00)
Bruno Gaussorgues	Gaselys	A
Stanislas de Calonne	Gaselys	A
Emmanuelle Sebtou	ISDA	A
Greg Salter	KPMG	A
William Wellbelove	KPMG	A
Joerg Sperling	RWE Trading	A
Karl-Peter Horstmann	RWE Trading	A
Simon Smith	Shell	A
Adrian Chalcraft	Triland Metals Ltd	A
Bernhard Walter	VDEW - German Electricity Association	A