

**To:**

**Mr Patrick Pearson,**  
Head of Unit,  
Financial Markets Infrastructure (G2),  
DG for the Internal Market and Services,  
The European Commission,  
BERL 10/034,  
B-1049 Brussels,  
Belgium

Friday, 02 November 2012

**RE: Concerns with regard to the EMIR Regulatory Technical Standards**

Dear Mr Pearson,

On 27 September 2012, the European Securities and Markets Authority (ESMA) submitted the draft Regulatory Technical Standards (RTS) to the European Commission (EC) for endorsement. Once approved through Comitology, the RTS will serve as a reference for the implementation of the EU Regulation 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR), which came into force on 16 August 2012.

The members of the European Federation of Energy Traders (EFET)<sup>1</sup> call for continued recognition that EU energy markets need appropriate treatment under the new EU financial regulatory proposals. Traded wholesale markets in electricity and gas are an essential feature of an open and liberalised European energy sector and it is crucial that these markets are not undermined.

In their current version, the draft RTS present a number of misconceptions and inconsistencies with the Level 1 text, that EFET feels compelled to address in order to avoid that the implementation of EMIR has unintended - negative - consequences for the EU energy market. Although we understand that the EC is preparing a Q&A document that should already address some of the main concerns of our members, we would like to indicate which issues are of most concern to our members:

- EFET appreciates that ESMA has partly addressed market participants' concerns with regard to the definition of hedging (by also including proxy hedging and portfolio hedging) and the clearing threshold (by raising the level of the clearing threshold). **We do, however, strongly oppose the idea that crossing a threshold in one asset class would trigger clearing (and thus margining requirements) in other asset classes and for other entities part of the same**

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<sup>1</sup> EFET is an industry association which was set up in order to improve the conditions of energy trading in Europe, mainly in electricity and gas markets. Established in 1999, EFET represents today over 100 companies in 27 European countries. EFET works to promote and facilitate European energy trading in an open, transparent market unhindered by national borders. More information at: [www.efet.org](http://www.efet.org).

**group , or that the threshold may be breached at group level although taken individually its entities remain below such threshold.** This would especially have a severe impact on the commercial hedging treasury- and foreign exchange activities of market parties by creating a clearing ‘cliff-edge’ resulting in a significant liquidity squeeze on non-financial firms.

There is also **no reference in the Level 1 EMIR text** to a requirement that if a party surpasses a clearing threshold in one class of OTC derivatives its group should automatically be required to clear all other classes: Article 10(4)(b) of EMIR provides that ESMA shall develop regulatory technical standards specifying:

*“values of the clearing thresholds, which are determined taking into account the systemic relevance of the sum of net positions and exposures per counterparty and **per class of OTC derivatives**”.*

For a detailed explanation, we would like to refer the letter addressed to the EC on October 31<sup>st</sup>, 2012 by EACT, EFET, Eurogas, FOA and OGP<sup>2</sup>.

- As indicated in previous communication with various governmental and European bodies, EFET is convinced that companies with a predominantly physical energy supply business do not pose systemic risk in the wider financial markets, particularly where activity is mainly focused on hedging commercial risks. **However, no specification in the EMIR level 1 text or in the RTS makes a clear point that physically settled commodity forwards should not count towards the clearing threshold.** The European Commission should clarify the exclusion of such contracts like it is explicitly excluded under the Dodd-Frank Act.
- ESMA proposes to implement clearing thresholds based on general *gross positions*. This approach is contrary to the purpose of EMIR, which is to measure the underlying exposure of non-financial counterparties in OTC derivatives and, where such exposure is identified as bearing a potential systemic risk, to mitigate this risk. EFET agrees with the EMIR purpose and **has therefore a strong preference of basing the clearing threshold on a netted figure.**

A figure referring to netted exposure is not only more representative of the risk carried by firms, but is also more consistent with the Level 1 EMIR text which expressly refers in its Article 10.4.(b) to:

*“the sum of net positions and exposures per counterparty and per class of OTC derivatives”.*

Setting the clearing thresholds by reference to gross notional values, where the notional value of the underlying often bears no relation at all to the actual size of the exposure under OTC derivative transactions, means that the clearing obligation will be triggered (with all of the consequences that entails) at a level far below that of systemic relevance. ESMA has indicated that non-financial firms may find it difficult to deal with a clearing threshold set on a net basis (RTS recital 77). EFET does not believe this is the case and ESMA has not provided any evidence to support its conclusions. Exposures based on netted positions are at the basis of even the simplest trading system and could thus easily be implemented by all concerned companies.

ESMA further believes that its criteria would reflect the structure of OTC derivatives activities that [anyway] lead to a low level of netting as OTC derivative contracts are concluded in the

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<sup>2</sup> See letter attached.

same direction. This assumption is contradicted by easily verifiable market realities. EFET therefore urges the European Commission to look again at this important issue. We consider that the clearing threshold should be set on a net basis to reflect a better measure of potential market risk and as explicitly required by EMIR. At the very least the gross threshold needs to take full account of the high notional value of commodity derivative contracts compared to other asset classes. Preferably, transaction data collected under EMIR should be used as a basis to set the thresholds at an appropriate level. As such, we do not support the €3 billion threshold proposed by ESMA.

- The criteria proposed by ESMA in the RTS for commercial bank guarantees (CBG), article 40 on page 125 of RTS, will mean their usability by non-financial firms will be significantly limited. **We strongly believe that the use of CBGs – because only non-financial (and non-systemic) parties are allowed to use them – should not be restricted as much as ESMA proposes.** In particular, the RTS propose that CBG’s should be fully backed by collateral that can be realised on a same day basis. This requirement makes it impossible to use bank guarantees as non-financial firms would need to effectively hold equivalent cash amounts or increase credit lines, which is not achievable at reasonable cost in a cash liquidity constrained environment. This would mean that some market parties cannot fully back or collateralise their bank guarantees, and hence would lead non-financial companies not being able to use CBGs anymore to cover their (margining) exposure with Central Clearing Parties which would further increase their cash liquidity risks.

Combined with the clear intention to push OTC markets toward clearing (as set out in EMIR and MiFIR), we believe that the requirement of fully backed bank guarantees towards the energy sector is an unreasonable and disproportionate response to the risk exposure of the energy sector. Contrary, **this limitation may drive some market participants out of the market and deter hedging, which would introduce greater systemic risks into the energy market, counter to the goal of EMIR.** The delayed application of these requirements (3 years) would in that sense be insufficient.

- **The RTS need to ensure that risk mitigation requirements for non-cleared contracts do not duplicate existing and fully effective industry arrangements,** which would lead to unnecessary additional costs for firms. Existing EFET and ISDA agreements, as well as bank guarantees should be accepted without caveat as eligible collateral. This would also clearly reflect the intention of the Level 1 text which urges in Recital 31 to “recognise the methods of risk mitigation used by non-financial counterparties in the context of their normal business activity”.

In this respect we ask the European Commission also **for a clear statement that contracts that are already centrally cleared (under existing arrangements) do not count towards the clearing threshold,** which was not clarified in recital 72 of the RTS.

- **Intra-group transactions do not have an adverse effect on exposure of firms to external counterparties and they should be clearly excluded** from both counting towards i) the clearing threshold, ii) any requirement for clearing in the event a non-financial firm breaches the threshold, iii) any reporting requirements and iv) any additional risk mitigation requirements, in accordance with the letter and the spirit of EMIR level 1 text. It should be recognised that intra-group transactions often make a company’s exposure more transparent and, thereby, more easily and adequately handled.

- In order to be consistent with its recognition of portfolio hedging in the latest version of the draft RTS, **the standards should acknowledge that market parties should not be required to report whether every trade is a risk reducing or not, and whether it is below or above the threshold.** It would make no sense to introduce these requirements for the transaction reporting obligation, while they're not required under the other sections of the RTS.
- Although further clarity was given on the timeline for the implementation of EMIR compared to earlier version of the draft RTS, **it is crucial that a fully transparent implementation roadmap is established** after consultation of market participants, in order to ensure that market participants can move to implementation as soon as the details become available. In particular, concerning non-financial counterparties, we deem necessary that the EU Commission introduce an explicit phase-in period of 6 months for the implementation of the clearing obligation after a contract has been deemed eligible for clearing.

If these concerns are not addressed, EFET believes that the implementation of EMIR could reverse the progress achieved in the European market for electricity and gas. Non-proportionate and overlapping regulation could deter widespread participation in wholesale energy markets. That would threaten overall wholesale power and gas market liquidity, would increase overall levels of risk and reduce investment capability; this at a time when the EU is seeking to enhance further the functioning of the single market in energy, following the implementation of third EU energy legislative package. A downturn in market liquidity and depth could in turn adversely affect the degree of competition in downstream energy markets and thereby be to the direct detriment of consumers.

To this end, EFET urges the European Commission to address the concerns listed above in its review of the draft RTS submitted by ESMA, and hold on the key principle of differential and appropriate treatment of the EU energy markets under the new EU financial regulatory proposals.

For further comments we would be happy to get in touch with you. Please refer to Karl Peter Horstman (Chairman of the EFET Market Supervision Committee, [karl-peter.horstmann@rwe.com](mailto:karl-peter.horstmann@rwe.com)), Cemil Altin (Vice-chairman of the EFET Market Supervision Committee, [cemil.altin@edftrading.com](mailto:cemil.altin@edftrading.com)), or Reinier Waters (Chairman of the EMIR work group at EFET, [reinier.waters@nuon.com](mailto:reinier.waters@nuon.com)).

Kind regards,

On behalf of the European Federation of Energy Traders,



Jan van Aken  
Secretary General