

# EFET Approach Regarding Unresolved EMIR Implementation Issues

2 May 2013

## I. Calculation of the Clearing Threshold (CT):

1. *When identifying the derivative contracts relevant for the CT calculations, firms will rely on the lists of authorized MTFs and regulated markets made by ESMA*

ESMA publishes a list of regulated markets and MTFs (<http://mifidatabase.esma.europa.eu/>), and national regulators have an obligation under Article 47 MiFID to maintain such lists in their jurisdictions. Market participants will therefore rely on these lists in order to assess their contracts.

As mentioned above, market participants underline that many of the UK brokers used for their trading purposes have FSA permission to operate MTFs but have at the same time FSA permission to conduct ordinary brokerage activity as well (i.e. “to arrange deals”, “make arrangements with a view” or act as “name passing broker”).

Most brokers therefore operate on two bases:

- (i) in one capacity, they operate MTFs enabling participants in those MTFs to enter orders and enter into trades in a way determined by the functionality and non-discretionary rules of the system;
- (ii) in another capacity, they act as discretionary brokers, working orders and executing transactions manually.

It is in the latter capacity that they intermediate between energy trading companies, passing names but leaving it to each market participant to confirm and settle their transactions. These transactions can thus not be regarded as “traded on an MTF” for the purpose of Section C6.

2. *Market participants will rely on the criteria of the definition in Reg.1287/2006 article 38 to exclude spot transactions from the definition of derivatives.*

The Commission's FAQs of February 2012 have clarified that energy spot transactions are not financial instruments under MiFID and therefore not within the scope of EMIR.

Article 38(2) considers that spot contracts outside of the scope of MiFID would be contracts for the sale of a commodity, asset or right under the terms of which delivery is scheduled to be made within the longer of either (a) two trading days; or (b) the period generally accepted in the market for that commodity, asset or right as the standard delivery period.

The "period generally accepted in the market" for oil, coal and LNG spot contracts is much higher than 2 business days and varies between 30 and 90 days. We wish to make ESMA and the Commission aware of these specificities and to ensure that these contracts are captured by the definition of "spot" contracts.

Finally, the regime of spot foreign exchange contracts should be clarified.

3. *Derivatives concluded OTC but voluntarily centrally cleared within day through a clearing house are excluded from the calculation of the CT.*

To clarify the debate on voluntarily cleared derivatives, a distinction needs to be made between two different types of instruments:

- (i) OTC contracts concluded with the condition that they will be cleared ("Subject to clearing"). These contracts do not come into existence until after they have been given up for clearing, i.e when the condition precedent is fulfilled. An OTC derivative contract does therefore not exist and is not available in the trading systems. The contractual relationship is only existing with the clearing house or the clearing bank, as applicable.
- (ii) OTC contracts, often concluded via a brokered screen (i.e. without knowing the identity of their counterparty), and simultaneously or immediately afterwards given up to an exchange for settlement and clearing by the relevant clearing house. In accordance with the applicable rules of brokers and exchanges, the *give up* occurs within day. That transaction is registered with the exchange and submitted to the rules of the exchange. The counterparty to these transactions is the exchange/regulated market itself.

Regarding the second type of instrument, while traded bilaterally, the execution of these transactions occurs on a regulated market which removes the nature of the trade as concluded 'OTC' and consequently the underlying counterparty risk. The ESMA Q&A document relies on the wrong assumption that these OTC derivatives remain as 'OTC' in the trading systems, and that counterparties only decide at a later point in time to proceed to clearing.

This does not reflect market practices: all risks of default have been moved to the clearing system, in accordance with the purpose and aim of EMIR. These transactions are accounted for with the regulated market with the same principles (they are included in the daily collateral requirements of the clearing houses) and are deemed equivalent to transactions executed directly with the regulated market. OTC derivatives cleared on regulated exchanges therefore lose their qualification as “OTC Derivative” according to EMIR, because they are taken up in the systems of the exchanges<sup>1</sup>.

4. *Issues on the determination by NFCs of the status of their counterparties ( is it a Financial Counterparty (FC) a NFC breaching the threshold (NFC+) or a NFC not breaching the threshold (NFC-)?)*

EMIR does not state that counterparties must disclose whether they are an NFC+ or NFC- to their trading counterparties. The only notification requirement prescribed within the regulation is to be made to the NRA/ESMA if the firm is a NFC+.

When trading in OTC derivatives, EFET believes that the exchange of appropriate pre-contractual documentation of the type of “know your customer” questionnaires will suffice to establish bona fide the status of counterparties. At the same time and to provide further clarification in the markets EFET would support the publication of counterparty status (NFC+ or NFC below the threshold) on ESMA’s site.

5. *Notional value*

- *For the notional value of options, only the premium should be relevant (cf. US model).*

The RTS does not dictate the method for calculating the notional value of options to be counted towards the clearing thresholds. Presumably, the notional value of options would be calculated based on the option premium. ESMA has indicated that the use of market values is not appropriate, since calculating anything more complex than this would be difficult for many NFCs.

All the same, market participant will either rely on the input of US Associations to the CFTC in order to calculate the notional value of time-, product-, and locations spreads or after some time develop an own methodology which will be submitted to ESMA in due time.

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<sup>1</sup> See for example §1 (2) of the EEX OTC clearing conditions: OTC clearing is defined as “the bilateral exchange of trades concluded outside the exchange and the registration of these trades as OTC trades into the EEX trading systems by mutual consent provided said trades are approved for such and said entry is carried out subject to certain the conditions”. See also §10 (1) of the EEX OTC clearing conditions: “Upon entry of an OTC trade with a valid price into the EEX system, which is confirmed by the other party, the regulations regarding the conclusion of trades and regarding the contractual obligation of the clearing conditions of the ECC or the clearing conditions referred to herein shall apply accordingly with regard to the contractual relationships between ECC and the Sub-CCP taking part at the clearing procedure via ECC respectively and the trading participants involved in the OTC trade and/ or their clearing members”.

- *The notional value of contracts where prices are not publicly available but will only be available by the time of settlement shall be estimated from yearly average price.*

For their immediate needs of calculation of the clearing thresholds, market participants will take into account the average price in the last year, in order to establish the gross notional amount of these types of products.

6. *It appears that derivatives traded on third country exchanges such as NYMEX, DME etc. would be defined by EMIR Art 2(7) as "OTC derivatives" since ESMA has not published a MiFID 19(6) list of "equivalent markets" as such. On the basis of this assessment, EFET understands that all such OTC derivatives that do not reduce risk are counting toward the threshold, regardless of whether they are cleared or not. EFET would therefore move for the urgent adoption of third country "equivalent markets" is expected.*

The understanding of EFET is that derivatives traded on third country exchanges which are not recognised by MiFID as a third-country equivalent market would be treated as an "OTC derivative" for the purposes of EMIR. Failing any designation of third-country equivalent markets, only those "OTC" derivatives which are risk reducing would not count towards the clearing threshold, regardless of whether the transactions are cleared or not.

As ESMA appears to share this assessment in its March 2013 Q&A document<sup>2</sup>, we urge ESMA and the European Commission to adopt a list recognising third country exchanges as a proxy for the determination of "equivalent markets" until ESMA actually publishes a MiFID 19(6) list.

## **II. Clearing Obligation**

7. *EFET would appreciate a clearer timeline as regards the list of eligible clearing contracts to be issued by ESMA*

The Commission FAQ on EMIR has stated that the intention is that ESMA will be in a position to start its assessment of products within the first quarter of 2013 and the first clearing obligation could enter into force very soon after the first authorisations/recognitions of CCPs under EMIR, i.e. as early as September 2013.

EFET would welcome clarification from ESMA and the European Commission with regard to the timeline, especially with regard to the timing of the Commission approval procedure for the list to be drafted by ESMA. The industry would expect clearer timelines to facilitate implementation

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<sup>2</sup> "Derivative contracts executed on non-EU exchanges that are equivalent to a regulated market in accordance with Article 19(6) of MiFID do not count for the purpose of the determination of the clearing threshold. Derivatives traded in other non-EU exchanges will count for the determination of the clearing threshold. To date, there is no publicly available list of non-EU exchange equivalent to a regulated market, as envisaged under Article 19(6) of MiFID.", OTC Answer 1 (c), *ibid*.

preparation, and clarity on the impact on compliance obligations in case of delayed implementation.

8. *Banking-licensed entities within a group of non-banks will benefit from the intra-group clearing exemption under the conditions highlighted hereunder.*

If the main EU-established entity within a group were a banking-licensed entity, then the group would be a financial counterparty and therefore have to meet the requirements of Article 3(2) of EMIR when conducting intra-group transactions with non-financial counterparties within its group. This includes the Commission adopting an implementing act under Article 13(2) in respect of any transactions with a third country NFC in the group.

If the main EU-established entity within a group is a NFC concluding intra-group transactions, then the requirements in Article 3(1) of EMIR will have to be met. This includes the European Commission having adopted an implementing act under Article 13(2) in respect of any third country for any banking-licensed entities which are not established in the EU.

9. *EFET would appreciate a clearer timeline for the publication and adoption of further guidance by national regulators in relation to the criteria for Intra-group-exemptions and the notification/ application for this purpose*

We understand that template notification forms are being prepared by national regulators and could be available to market participants in the coming weeks. Any further clarification by ESMA would be appreciated.

10. *ESMA should recognise that there a number of approaches that can be utilised by firms to identify their hedging activity for EMIR as long as these are consistent with the EMIR text and the Implementing Standards.*

This includes, but is not limited to, an accounting, book structure, transaction by transaction or risk based approach.

### III. Risk Mitigation Obligations

11. *With respect to timely confirmation, we would appreciate ESMA to confirm the following understanding:*

- *Concerning compliance of market participants as regards the timely “exchange” of confirmations in the absence of any reply of the counterparty, EFET acknowledges that the due diligence obligation ends with sending out the confirmation and having solicited the response.*

Market participants will rely on the answer to Part II, Q13 of the Commission’s FAQ published on the 8<sup>th</sup> February 2013

The rules “do not introduce hard deadlines to be complied with case-by-case. If a firm has appropriate procedures and arrangements in place, but nevertheless does not achieve the deadline for legitimate reasons, this should be reported to its competent authority. The competent authority should examine the procedures and arrangements of the firm in respect of its obligations under Article 11(1) of EMIR and determine whether the firm has made sufficient efforts to achieve the deadlines”.

- *The timeliness for the confirmation process in Art.12 148/2013 refers to the own status of the entity and the absence of confirmation by the counterparty within these period is not regarded automatically as non-compliance.*

We understand that each entity has to ensure that each trade is confirmed within the period defined in Art. 12 of Commission Regulation 148/2013. This would imply different time periods for trades between companies with different status (FC, NFC+, NFC-). The requirement for timely confirmation is met if each party to the trade confirms within the respectively applicable period of time; e.g. a FC confirms deal details within two days, while a NFC is to confirm deal details only after five days.

12. *With respect to ‘Confirmed via electronic means where available’: We seek a clear definition of ‘electronic’ and ‘where available’:*

- *An electronic confirmation (paper confirmation sent out via pdf vs. fully automated 3<sup>rd</sup> party electronic matching platforms such as ICE eConfirm/EFET eCM) is ideally sent via a third-party electronic matching platform.*

ESMA has suggested that electronic confirmations are those which form an electronically executed contract and that is distinct from a paper document signed by both counterparties. While this is not entirely explicit in the RTS, the increasing industry consensus is that electronic confirmation is more likely to be a type of third-party electronic matching platform.

- *If a product is offered as electronically confirmable on a platform that market participants do not use (such as ICE eConfirm), they shall not be required to sign up to the platform (thus incurring administrative and IT set up burdens and additional costs) to fulfil this requirement.*

No such requirement is made explicit and it is not believed that such an additional requirement could be added through the RTS (hence the wording “where available” in EMIR, Art. 10.1(a)).



13. *The implementation time of 4 months for mandatory clearing becoming enforceable is not applicable for risk mitigation techniques in respect of NFCs+ (Art. 11 (2) and (3))?*

The mandatory clearing obligations are not directly related to the risk mitigation activities which firms must undertake. Before the technical standards for collateral requirements enter into force, counterparties have the freedom to apply their own rules on collateral in accordance with the conditions laid down in Article 11(3). As soon as the technical standards enter into force however, counterparties will have to adapt their practices and procedures to the extent necessary in order to comply with the standards. The technical standards will apply to relevant contracts concluded as of the date that they enter into force.

14. *EFET would appreciate national regulators/ESMA to issue further guidance under the RTS on how NFCs shall practically implement the portfolio reconciliation, compression and dispute resolution requirements.*

There are currently no standards for portfolio reconciliation and compression in the market. Market participants will have to evaluate the setting up of own systems or procedures or the purchase of third party systems/services in order to fulfil their obligations under the RTS. Guidance on the requirements expected by ESMA for such systems would be necessary in order to provide further clarity and understanding.

Dispute resolution clauses are already part of standard trading agreements (such as ISDA) in use in the market, foreseeing the recording of telephone conversations (which will help identifying, recording and monitoring disputes in relation to the recognition or valuation of contracts) and jurisdiction/arbitration clauses which provide for timely resolution of disputes.

#### **IV. Transaction reporting under EMIR:**

15. *As regards the accepted format: fpml, cpml, xlm, csv, excel, market participants' choice should be respected.*

No format is specified in the regulation or the RTS. Market participants' choice should be respected if they have a preferred format. NFCs should be free to choose the reporting format best suited to their needs and not necessarily be imposed financial sector reporting standards.

16. *Legal Entity Identifiers*

- *Clearer timelines are expected from ESMA and NRAs as regards the availability of the final LEI.*

No timeline is specified. More detail on the timeline would be beneficial for market participants.

- *A third party should be responsible for assigning the LEI.  
(Reference: Draft technical standards under the Regulation (EU) No 648/2012, ANNEX VI, Table 1 item 2.)*

A third party should be responsible for assigning the LEI. Market participants should not be required to do this. It is necessary to know who this third party shall be appropriately in advance.

### 17. Unique Trade Identifiers

- *A third party should be responsible for generating the Unique Trade Identifier (UTI).  
(Reference: Draft technical standards under the Regulation (EU) No 648/2012, ANNEX VI, Table 2 item 8)*

A third party should be responsible for generation the UTI as market participants otherwise would not be able to know if the UTI is still available. Third party coordination will avoid uncertainty.

It is envisaged that unique trade ID formats will eventually be agreed at the European level, an initiative supported by EFET. Until then, it is incumbent upon the counterparties to develop their own trade identifiers in line with the 52 alphanumeric digits requirement in the legislation. EFET would appreciate further guidance on the UTI.

- *As regards a possible agreement between market participants agree on who should carry the obligation to report the Common Data which is only to be submitted once, EFET considers the following approach.*

Based on the explanatory statements in the RTS, the use of a unique trade identifier is partly to be helpful in cases "where counterparties are reporting to two different TRs". Furthermore, the text of Article 1(3) of Annex VI of the RTS suggests that it is only where one report is being made on behalf of both counterparties that the information in Table 2 ("Common Data") should only be submitted once. Where each counterparty is submitting independently and there is no agreed delegate, the RTS do not appear to preclude each reporting both Table 1 ("Counterparty Data") and Table 2.

ISDA is working on a set of standard terms which provide options for parties to base their reporting requirements on, whether this is (i) each party reporting independently (by itself or through a delegate), (ii) one party taking on the reporting obligation for both counterparties to the trade or (iii) both counterparties delegating the reporting to a common third party. It seems likely that there will be pressure from buy-side clients to have the dealers perform reporting on their behalf. Furthermore, it is also likely that dealers will be pushing for exchanges and clearing houses to provide reporting services for on-exchange or cleared trades.



## 18. Unique Product Identifiers

- *Probability for a UPI*

The production of UPIs is required by Article 4 of Regulation 1247/2012. EFET is supportive of ISDA's work to develop the UPI, and would support this market-born initiative. Once finalised, we encourage regulators to consider those standards.

- *EFET moves for an early clarification of the taxonomy for trades (Reference: Draft technical standards under the Regulation (EU) No 648/2012, ANNEX VI, Table 2 item 1)*

Market parties will need to know relatively soon what kind of taxonomy will be used under EMIR transaction reporting. It is not clear when universal unique trade/product identifiers will become available and once they do, when they will be "endorsed" in the EU.

These Unique Product Identifiers should be available as soon as possible as it will cost a lot of time to implement them and match them with the product names that are currently being used.

As interest rate derivative will have to be reported first, the issue for them is most pressing. It would also be good to know what trade repository will be responsible for the interest rate swaps, as they will have to be reported first.

## 19. *A designated reporting company does not have to be authorised to report for other entities of the same group.*

There does not appear to be any authorisation regime for third party reporting entities. The reporting obligation remains with the transacting counterparty regardless of any third party reporting arrangements.

## 20. *Art. 2 of the proposed delegated regulation on TRs (Annex VI of the RTS) Applies to the Trade Repositories only*

We assume that Art. 2 only applies to the TR, since counterparties would already be keeping a record of any modifications reported under EMIR L1 9(2).

*21. The RTS include the requirement to differentiate on a trade-by-trade basis between hedges and speculative deals. NFCs shall nevertheless not have to differentiate between hedges and speculative trades on a trade-by-trade basis under the EMIR transaction reporting requirements?*

*(Reference: Draft technical standards under the Regulation (EU) No 648/2012, ANNEX VI, Table 1 item 15 and 17)*

As recognized by ESMA, most energy companies are not able to differentiate between risk mitigating and speculative trades on a trade-by-trade basis. The fact that portfolio hedging is recognised acknowledges this fact. Reporting trades on a trade-by-trade basis will be difficult, if not impossible, if market participants applied portfolio hedging. However, the RTS includes the requirement to differentiate on a trade-by-trade basis between hedges and speculative deals.

Market parties that already report on a portfolio basis on their hedges vs. speculative deals should not be required to do so on a trade-by-trade basis. Please note that it is possible to report MTM on a trade-by-trade basis, but that these numbers do not always match due to the fact that market parties calculate them differently.

*22. Trade stamps should suffice to fulfil the criteria regarding the timing of the trade.*

*(Reference: Draft technical standards under the Regulation (EU) No 648/2012, ANNEX VI, Table 2 item 30)*

Currently the time at which a trade was done is not recorded. The trade date, however, is recorded. A trade only gets a time stamp when it is entered into the system. As this always happens within the day, we believe it should be sufficient to report this.

*23. Multiple reporting of similar data under EMIR and REMIT should be avoided.*

EMIR does not use the term market participant in the same manner as REMIT. "Market participant", while undefined, is used in a much broader sense in EMIR and not related directly to transactions in wholesale energy markets. EFET would like to reiterate the need for the regulators, ESMA, and the European Commission to make sure that market participants are not subject to multiple reporting of the same data. Inter-regulator communication should be made fully effective in that regard.