



## **EMIR REFIT: JEAG's comments on the EU Institution's proposals to provide relief for the real economy (13 June 2018)**

The Joint Energy Associations' Group (JEAG)<sup>1</sup> welcomes the EU Commission's legislative proposal for a review of EMIR (dated 4 May, 2017 (COM(2017) 208 final) in as far as it leads to a simplification and improvement of EMIR's framework. In principle, this approach was followed by the European Parliament and the Council in their according reports.

In the following sections we mention proposed changes of these EU Institutions which we support because they eliminate disproportionate costs and burdens on non-financial firms and simplify EMIR rules. However, we also highlight our concerns against a policy change with regard to the EMIR clearing thresholds.

### **1. Hedging Exemption and Clearing Thresholds**

EMIR exempts non-financial firms ("NFCs") from mandatory central clearing and bilateral margining obligations if they do not breach the clearing thresholds as defined in the Regulatory Technical Standard (EU) No 149/2013 of 19 December 2012 ("RTS"). Article 10 of EMIR and the same RTS provides that OTC Derivatives used for the mitigation of risks stemming from the operative businesses (e.g. to hedge against currency, interest rates or commodity price fluctuations) are not counted against the clearing thresholds ("Hedging Exemption").

In this context, we welcome very much the political decision of the EU Commission ("EC") and the Council to retain the current hedging exemption and the clearing thresholds without any further changes.

Regarding the ECON proposal, we reject the proposed policy change (a) to update the RTS "regularly" with regard to the definition of what constitutes hedging and the clearing threshold and (b) to periodically review the clearing threshold "to ensure increased participation in central clearing" for the following reasons:

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<sup>1</sup> JEAG represents the entire value chain of the energy industry across the EU and consists of the following associations: BDEW, BDI, DAI, EFET, Energy UK, Eurelectric, Eurogas, IOGP and VKU.

- The objective of EMIR is to force systemic counterparties into the full scope of the regulation. However, NFCs are not systemic and there is no regulatory need to regularly review clearing threshold to increase the clearing rate as NFCs do not pose any material threat to the financial stability. This is also acknowledged in the EMIR Review proposal of the EC (see recital 7): “Non-financial counterparties are less interconnected than financial counterparties. They are also often active in only one class of OTC derivative. Their activity therefore poses less of a systemic risk to the financial system than the activity of financial counterparties.” Furthermore, this is confirmed by ESMA as stated in the “EMIR Review Report no. 1”: NFCs represent a large share of total number of counterparties in OTC derivative markets (72%), but a very small proportion of the volumes (7% of the outstanding volumes as measured by trade count and 2% of the outstanding volumes as measured by notional amount).
- To adjust the clearing thresholds in order to push more NFCs into the clearing obligation would lead to an un-level playing field at international level and put European non-financial companies in a less favourable position compared to their international competitors. In a EMIR Review non-paper of 29.11.2016 the EC stated that the clearing thresholds and the definition of hedging under EMIR reflects common international standards as NFCs are not subject to mandatory clearing in other major third countries with important derivatives markets (Japan, U.S., Canada, Australia, Singapore, Hong Kong, Republic of Korea). Also, this change in EU policy is in conflict with more recent international developments to relax rules as for example the recent review activities of the Dodd-Frank-Act have delivered less stringent rules, not the opposite.
- We insist that the criteria to establish what is hedging and the clearing thresholds should not be reviewed and changed regularly. Retaining the current and well established hedging definition and the clearing thresholds is obviously the aim of all co-legislators, as neither ECON, Council nor the Commission proposed any amendments for adjustments.
- Such regular changes would create legal uncertainty and have a material adverse impact on NFCs under EMIR but also under other financial regulation such as MIFID II. In particular small and medium sized NFCs would be pushed out of the market as they can't afford the compliance burdens and costs of central clearing and bilateral margining. The remaining larger NFCs wouldn't be able to rely on the existing clearing thresholds since there is a risk that they would breach any future and non-foreseeable thresholds. This would, therefore, disincentivize these NFCs to provide liquidity and offer risk reducing OTC Derivatives to the market. Altogether, this would dramatically reduce the liquidity of OTC markets and increase substantially the hedging costs of the energy utilities and real economy. Ultimately, this will lead to considerable higher energy costs for the end consumer and industry.
- Lastly, the proposal to review the thresholds periodically is superfluous as ESMA already has this mandate in the current EMIR text. Consequently, there is no need for this policy change as it should be expected that ESMA would already take all relevant factors into account when considering any changes to the clearing threshold - including expected rates of clearing, ability to clear, impact on liquidity, costs of clearing and cost to end consumers. The proposed policy change would prevent such full impact assessment and, therefore, not comply with better regulation principles. In any case, for the reasons mentioned above we do not see the need for any adjustments.

## **2. Mandatory Clearing and risk mitigation by NFCs**

We welcome the EC proposal that NFCs above the clearing threshold (so called NFC+) are subject to the clearing obligation only with regard to the asset class(es) that exceed the clearing threshold. This would avoid a cliff-edge effect for the entire corporate group, i.e., that all OTC derivatives (incl. FX and IR derivatives) across the entire group have to be cleared if the breach of the clearing threshold occurs only in one asset class (e.g. commodity derivatives).

However, the benefits of this “ring-fencing” would be very limited for NFCs if there is still the requirement for bilateral collateralization for all asset classes, in particular as this would concern even hedging transactions. Therefore, we welcome the ECON proposal which brings both requirements – for clearing and bilateral collateralisation – in line by stating that the bilateral collateral exchanges aren't necessary with respect to the asset class(es) for which the clearing threshold has not been exceeded. Hence, these two changes together would ensure that mandatory clearing and collateralisation applies only to the asset class for which the clearing threshold has been exceeded and, therefore, protects corporates from disproportional costs and compliance burdens.

For the same reasons we support the ECON proposal to exempt intragroup transactions of NFCs from risk mitigation techniques under Article 11 (1) of EMIR (timely confirmation, portfolio reconciliation, etc.). This change is welcomed as these obligations can be particularly onerous for non-financial entities within a non-financial group that is not subject to the clearing obligation. Also, this proposal aligns the treatment of intragroup transactions with the EC proposal to exempt intragroup transactions from reporting.

## **3. Reporting by NFCs**

- The EU Institutions proposed changes to simplify reporting by NFCs, which eliminates disproportionate cost and burdens on NFCs at the same time. Therefore, we welcome the following proposals:
- It is helpful that all EU Institutions support single-side reporting (“SSR”) of OTC derivatives entered into by NFCs with financial counterparties (“FCs”).
- In this context, the Council and ECON propose that FCs shall be solely responsible and legally liable for SSR. We welcome this clarification that NFCs bear no responsibility for the reporting and accuracy of OTC derivatives with FCs. Any split of liabilities would neutralise the positive effect of SSR and force NFCs to implement new procedures for monitoring and validating FC's reporting on their behalf, which may easily exceed the resources spent maintaining the current levels of own reporting facilities.
- We support the proposal of the Council and ECON that NFCs have the choice between SSR and self-reporting to trade repositories. Many NFCs have heavily invested in an own reporting system and/or want to implement only one reporting solution for all of their transactions.
- We welcome the proposal of the EC to exempt intragroup transactions from reporting. However, it is necessary to exempt from the reporting obligation all transactions worldwide within a group where at least one of the counterparties is a NFC. This avoids any unintended detrimental impact for global groups, in particular because of the absence of the required equivalence decision with regard to 3<sup>rd</sup> country reporting

regimes. Therefore, we support the proposal of the Council and ECON to extend the exemption to intragroup transactions on the world wide group.

- The ECON proposes a practical solution to ensure that 3<sup>rd</sup> country FCs can report OTC derivatives on behalf of NFCs. We support this proposal as this would avoid that NFCs would need to maintain two reporting set-ups for some of their non-EU business.

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