

ESMA
103 Rue de Grenelle
F-75007 Paris
Online submission

Kontakt
Alexandra Gruber

DW
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Discussion Paper: Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories, 16 February 2012
Comments by Oesterreichs Energie (Register ID number: 80966174852-38)

Dear Madam,
Dear Sir,

Oesterreichs Energie, the Association of Austrian Electricity Companies, welcomes the opportunity to comment on the Discussion Paper: Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories, 16 February 2012. Oesterreichs Energie represents more than 130 energy companies active in generation, trading, transmission, distribution and sales which in total cover more than 90 per cent of the Austrian electricity generation and the entire distribution.

Q6: What are your views on the review process following a negative assessment?

Whereas we agree to the review process in general, the further consequences of a negative assessment remain unclear. What will be the impact of a negative assessment on the decision of the national regulator that has triggered the whole process by its authorisation to clear a class of OTC derivatives? Will they have to withdraw this authorisation?

Q7: What are your views regarding the specifications for assessing standardisation, volume and liquidity, availability of pricing information?

The discussion paper does not include the public consultation according to Article 4, paragraph 3 of the Regulation. In our opinion, it is essential that stakeholders are enabled to take up a stance in every case – and not only in a general manner as this is currently approached in the discussion paper.

Q8: What are your views, regarding the details to be included in ESMA Register of classes of derivatives subject to the clearing obligation (Article 4b)?

In this section, the exact definitions of class and type of derivative contracts cause difficulties. As regards the general class of derivatives, does the term bear the same meaning as it is defined in Article 2, paragraph 4? In this definition, the Regulation specifically refers to the underlying commodity and the currency of the respective derivative. Both are facets of the broader term “class of derivative”. In the discussion paper, however, both aspects are mentioned in addition the term “general class of derivative” which indicates that they are separate points. This potential contradiction needs further attention.

Moreover, the definition of derivative type needs to be discussed. Does this term envisage general terms such as are forward, future and option? Or does it need to be linked to Section C of Annex I of MiFID?

Q10: In your view, does the above definition appropriately capture the derivative contracts that are objectively measurable as reducing risk directly related to the commercial or treasury financing activity?

Basically, the definition of reducing risk is a suitable one. As stated in the paper it is useful to enter OTC derivative contracts for hedging direct risks (production, value of assets, liabilities etc.) and that those quantities have to be considered within threshold.

The major challenge will be to define the appropriate methods how those hedging activities will be measured.

The question whether individual contracts are concluded to minimise risk, needs to be considered at the group level. Moreover, the concept of the term group needs to be interpreted as widely as possible. Holding significant shares (although not meeting the requirements of an affiliated company) and exercising common control should be sufficient in order to create a level playing field. Two companies having founded a joint trading branch shall not be treated differently from a company which has integrated the trading activities in the main entity as long as both businesses conclude derivative contracts to reduce risk.

Q11: In your view, do the above considerations allow an appropriate setting of the clearing threshold or should other criteria be considered? In particular, do you agree that the broad definition of the activity directly reducing commercial risks or treasury financing activity balances a clearing threshold set at a low level?

Generally, we agree to ESMA's approach to provide a broad definition of activities reducing commercial risk instead of proposing a very high clearing threshold to only compensate an inadequate definition of hedging. The definition of transactions reducing risk is a fundamental element of the Regulation and should therefore remain the main criteria whether non-financial parties should be treated like financial ones.

However, it is difficult to evaluate the current proposal as ESMA has not provided a concrete value of the threshold level. Moreover, the definition of risk reducing transaction has remained vague as well.

In the discussion paper, ESMA has not included a substantiated argument why it has opted for a single threshold across all asset classes. We do not believe that difficulties to implement a more sophisticated approach is a valid argument as the discussion paper foresees a wide range of other measures that are definitely difficult to implement (e.g. portfolio compression and reconciliation, time limits for confirmations etc.) as well. However, these other measures lack the prominent importance of the definition of the clearing threshold. At this stage, we would like to remark that the term “asset class” currently even lacks a meaningful definition.

Moreover, the notional value of OTC derivatives is an extremely rigid measure that does not make any allowances for the differences of the non-financial market participants.

To summarise our position, we would like to emphasise that the clearing threshold has been introduced to prevent non-financial counterparties from becoming systemically relevant for the respective financial market without being required to abide by the full regulation as provided by the Regulation. Setting a notional value for all asset classes definitely does not constitute an adequate and proportionate approach to guarantee this. At least, it will be necessary to *consider* different thresholds for substantially different markets. And it will be essential to discuss different thresholds for different non-financial counterparties. As the counterparties are concerned, we believe that a relative value (e.g. similar to the concept of ancillary activity in the recently proposed MiFID 2) will offer a less rigid and more individually suitable approach to this central subject.

Q12: What are your views regarding the timing for the confirmation and the differentiating criteria? Is a transaction that is electronically executed, electronically processed or confirmed generally able to be confirmed more quickly than one that is not?

When it comes to deadlines to be set for trade confirmations, the distinction between electronically executed, electronically processed and other transactions is reasonable. However, transactions that are entered into electronically and transactions that are processed electronically only need to be treated more differently. Moreover, the term “processed electronically” requires a more detailed definition. According to current knowledge, it would still imply that data is entered manually for further electronic processing. Of course, any manual operation would mean that the process is not fully automated. In such case, the period of 30 minutes after the conclusion of a non-electronically completed electronically needs to be questioned. Incidentally, it could be difficult to determine the point in time of the conclusion of a non-electronically executed contract in the aftermath.

Generally, time limits need to allow for some flexibility. If a trader is also obliged to enter the data of a contract manually to be further processed, it is unreasonable to believe that concluding and processing a contract is done strictly gradually. It must still be possible that a trader enters into more than a single transaction to fulfil the orders he/she is in charge of and that this trader provides for this data to be electronically processed afterwards.

Whereas these considerations are focused on rather formal questions, there are substantial problems in terms of content as well. In derivative trading business, the confirmation procedure is an important first level of control. Especially, failures that are obvious or easy to be

identified can be corrected by the back office or any comparable department at this initial state. In our opinion, this level of control should not be removed. Setting tight time limits is likely to cause more mistakes; hence a higher quantity of confirmations will have to be corrected. As a consequence, higher efforts would be imminent.

Finally, it is important to discuss whether reporting to the authorities and sending confirmations to the counterparty should be combined in any way at all. In our opinion, it would be more reasonable to submit a report to the competent authorities after the counterparties have agreed on the details of a transaction without any reservations. This is unlikely to happen before confirmations have been exchanged.

Q13: What period of time should we consider for reporting unconfirmed OTC derivatives to the competent authorities?

At least, this period should be above the limits discussed in section 38 and 39.

Q14: In your views, is the definition of market conditions preventing marking-to-market complete? How should European accounting rules used for this purpose?

First, the question what the "European accounting rules" stand for needs to be addressed.

Furthermore, another type market conditions is considered to be in the position to prevent a marking-to-market approach: material changes in the formula of indices and in the content, composition or constitution of product specifications.

Q15: Do you think additional criteria for marking-to-model should be added?

In particular, the contents of subsection 45.a are drafted too widely. In fact, every valuation model could be challenged as it is impossible to include the full complexity of the market. Hence, this subsection needs to be revised by stating that *most* factors need to be incorporated which an *average* counterparty would *reasonably* consider.

More generally, we question the whole approach as outlined in the discussion paper. Actually, the parties would be required to construct and keep available adequate valuation techniques for every asset class. In most master agreements, other fallback procedures are included. ESMA is highly advised to evaluate whether these alternative approaches can be regarded as satisfactory as well.

Q16: What are your views regarding the frequency of the reconciliation? What should be the size of the portfolio for each reconciliation frequency?

The following statement is based on the assumption that only future transactions which have not been (fully) performed yet are subject of the reconciliation procedure.

Generally, we agree that reconciliation of OTC derivative contracts is a proper means to reduce operational risks. The currently proposed frequencies, however, would require market

participants to make considerable investments. Full electronic support would be required to conduct a portfolio reconciliation on a weekly or even daily basis. Especially for small and medium companies these additional costs bear no relation to the expected benefits.

Moreover, ESMA is advised to consider the particularities of the single markets. In many cases, the market participants have installed well-functioning confirmation procedure. In energy markets, every delivery is furthermore scheduled on a day-ahead basis.

Consequently, the currently proposed thresholds for high frequency reconciliation are too low. For counterparts having concluded 300 financial OTC transactions (transactions that are entered into for hedging purposes need to be explicitly excluded from the calculation of these thresholds), a mandatory reconciliation should be envisaged for each quarter of a year.

Q17: What are your views regarding the frequency of the reconciliation? What should be the size of the portfolio for each reconciliation frequency?

The concept of portfolio compression is well known in the market. Generally, portfolio compression can offer considerable benefits for the market participants. However, its practical impact is limited which is mainly due to the high costs involved.

There are concerns that the introduction of a compression requirement will lead to increased costs as the participants will lose their opportunity to decide in favour or against this mechanism. Hence, any mandatorily defined frequency of reconciliation needs to be handled with caution.

Moreover, there are considerable doubts that it is reasonable to focus on the number of transactions only. ESMA is advised to consider a more sophisticated approach taking account of the notional value of the portfolio as well. There should be both, a reasonable high notional value and a sufficient size of the portfolio, to guarantee that a portfolio reduction remains a proper and adequate tool for the participants.

Finally, transactions that are entered into for hedging purposes need to be explicitly excluded from the calculation of these thresholds.

Q18: What are your views regarding the procedure counterparties shall have in place for resolving disputes?

A wide range of master agreements concerning the trade of derivatives (ISDA, IETA, EFET, German Master Agreement) already include detailed rules on this subject. Since these rules already exist, some inflexible rules, for instance the setting of time limits, appears superfluous and should be deleted. The provisions of the agreements go much further than the current proposals; additionally, they have already been tested. Moreover, the one-covers-all approach as outlined in 54 is not considered suitable as the types of transactions and derivative classes differ considerably. At best, global minimum standards could be imposed.

Furthermore, the parties' intentions to select a specific settlement procedure need to be considered. Generally, they try to avoid carrying on their controversies in public. In fact, a mandatory notification to the authorities would just result reduce both value and practical effect of these formal procedures to settle a case. At the same time, the additional value for the integrity of the respective market has to be questioned. Therefore, the involvement of the regulatory authorities is not considered to bring additional benefits.

Q19: Do you consider legal settlement, third party arbitration and/or market polling mechanism are sufficient to manage disputes?

Offering reasonable approaches and mechanisms to settle disputes effectively should have priority. Again, the market has already developed a wide range of such instruments (i.e. mediation, expert determination, postponement of pricing date, fallback price sources etc.). Restricting these approaches to three routes is therefore not considered useful.

Q20: What are your views regarding the thresholds to report a dispute to the competent authority?

In our opinion, involving the competent authorities generally does not offer considerable benefits. Therefore, if an involvement is considered at all, the threshold needs to be very high (i.e. systematically relevant).

Q69: What is your view on the need to ensure consistency between different transaction reporting mechanisms and the best ways to address it, having in mind any specific item to be reported where particular challenges could be anticipated?

We consider this a very important question. Especially, the energy market is confronted with the threat of extensive double reporting. In our opinion, the competent authorities will have to increase their efforts to synchronise their reporting requirements with one another.

Thank you for taking our comments into consideration. If you have any further questions, please do not hesitate to contact us.

Yours sincerely,

DI Dr. Peter Layr
President

Dr. Barbara Schmidt
Secretary General