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EFET response to ESMA Discussion Paper on rules under the Securities Financing Transaction Regulation

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The European Federation of Energy Traders (EFET)[1] welcomes Regulation EU 2015/2365 on Securities Financing Transactions (SFTR). We recognise that this Regulation responds to the need to enhance the transparency of the securities financing market and the shadow banking system.

EFET, the association representing European energy traders, is currently assessing the full scope of this Regulation to identify exactly what type of transactions would qualify as SFT. Generally, this kind of transactions are not part of the core business of our members.

In section §4.2.4.4 of the Discussion Paper ESMA mentions that "*commodities financing transactions subject to SFTR are predominantly bilateral buy/sell back transactions which are concluded in order to finance commodity inventories.*"

In the Q&A published by the EU Commission, it is mentioned further that commodities repos and reverse repos together with commodities sell/buy back are mainly driven by the need to borrow or lend cash in a secure way. Commodities lending or borrowing are more used for short-selling or settlement purposes.

We fully agree with the above statements; but have also reason to believe that there might be other scenarios which also apply to commodities, which could fall under the broad definition of SFTs *strictu sensu*, whilst the objective of such other commodity trading scenarios are other than seeking financing.

Therefore, in defining the trading scenarios ESMA must clarify that there is an intention to identify as SFTs only those commodity transactions that are entered into for the purpose of lending/borrowing in so far as they are alternative sources of financing to the more traditional

[1] The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent, sustainable and liquid wholesale markets, unhindered by national borders or other undue obstacles. We currently represent more than 100 energy trading companies, active in over 28 European countries. For more information, visit our website at www.efet.org.

banking system; and that it is not the intention to capture under the SFTR commodity sell/buy back or lending transactions entered into for reasons other than financing.

Although sell/buy back transactions in energy commodities may be common in some energy markets, in our view they are mainly entered into in the ordinary course of business to manage e.g. temporal or locational commercial needs, for instance gas storage or exchange of gas between two different market locations; but without any intention of seeking alternative sources of financing.

These types of transactions and activities are already subject to detailed regulatory oversight regimes and related reporting obligations, such as REMIT (Regulation 1227/2011) for physical and financial power and gas transactions and EMIR, and they do not constitute SFTs. This has already been clearly recognised by ESMA in respect of derivatives transactions subject to EMIR, but not yet in respect of transactions subject to REMIT.

Based on the above considerations, in our view SFTR should recognise that:

1. All REMIT eligible trades are excluded from the scope of the SFTR following the same logic as the exclusion of EMIR transactions.
2. Any reporting obligations should be aligned as much as possible to existing EMIR reporting processes and should not add any further unnecessary complexity and/or costly operational burden (same formats, processes, etc.).
3. Physical operations with commodity lending or borrowing; and/or physical buy/sell back commodity transactions (which are not subject to REMIT or EMIR) should only be subject to the SFTR if entered into for the purpose of financing. The SFTR should explicitly exclude other commodity trading scenarios dealing with operational constraints and optimisation, i.e. to get access to more liquidity.

We would, therefore, appreciate a clarification by ESMA in the final Regulatory Technical Standards and Implementing Technical Standards.

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In relation to the specific questions posed in the Discussion Paper, EFET has the following comments:

Q48. Would it be possible that an initially unsecured securities or commodities lending or borrowing transaction becomes collateralised at a later stage? Please provide concrete examples.

> Normally such transactions are collateralised at inception. The most common form of collateral are cash collateral or bank guarantees. However, this strictly depends on the credit policy and risk appetite of each counterparty. It may be possible, for instance, for operational purposes for transactions (or better total exposure) below a certain amount, to have no collateralisation, but the situation may change over time depending on the value of the open positions and/or increase of the trading activity with the counterparty.

So initially unsecured commodity transactions might become collateralised at a later stage.

Q49. Which of the scenarios described for securities lending (Section 4.2.4.2), repo and buy/sell back (Section 4.2.4.1) are currently applicable to commodities financing transactions? Please provide a short description of the commodity financing transactions that occur under each scenario and the involved actors.

We believe that bilateral trades with/without intermediation of a broker or purely bilateral transactions are the most common scenarios applicable to commodities.

Q50. Are you aware of commodity financing transactions that would fall in the scope of the Regulation but are not covered in the scenarios described for securities lending (Section 4.2.4.2), repo and buy/sell back (Section 4.2.4.1)? If yes, please describe the general characteristics of such a transaction.

We are aware of the opposite situation. Indeed, our concern is that the broad/general definition of the trading scenarios should be clarified to exclude any type of commercial transaction executed in the normal course of the business for energy commodity companies and which does not have an underlying purpose of financing/borrowing-lending. We understand this is not the intention of the legislator.

We remain available for further explanations concerning this type of transactions, common in the energy business, driven by commercial rather than financing needs.

Q51. Are the types of transactions recognised sufficiently clear for unambiguous classification by both reporting counterparties of commodity financing transactions into one of the types?

Q52. What additional details may help to identify the type of transactions used?

In order to achieve an unambiguous classification by the counterparties of commodity financing transactions by both the reporting counterparties we believe it is necessary to highlight that the purpose of the e.g. buy/sell-back transaction is the need to find sources of funding alternative to the traditional banking system.

Q53. What are the main types of commodities used in SFTs?

We believe that SFTs in commodities are mostly used for commodities that can be stored.

Q54. How often, in your experience, are other commodities used?

In general, in our experience commodities are used rarely for SFTs. We believe that the intention of the regulator was to capture commodities financing transactions in respect of commodities, which lend themselves more easily to standardisation, such as precious metals. In our experience, energy commodities, gas and power in particular, do not comfortably fall within the spirit or scope of the regulation.

Q55. In your experience, what share of the transactions involves standardised commodity contracts, such as most traded gold and crude oil futures? Please provide concrete examples.

Q56. In your experience, what share of the transactions involve commodities that meet the contract specification for the underlying to derivative contracts traded on at least one [EU] exchange?? If yes, please elaborate and provide concrete examples.

In our experience the SFTs are bespoke. The underlying commodity may be traded also on an exchange or other trading venue, but the SFTs are completely different contracts to those traded on exchanges. In other words, the object of the SFT is not the *standardised contract*, but rather the underlying commodity.

Q57. Do the proposed fields and attributes in Section 6.1 sufficiently recognize the characteristics of commodity financing transactions? Please describe any issues you may see and describe any reporting attributes that should be added in order to enable meaningful reporting of commodity financing transactions.

Many of the reporting fields are in our view not meaningful or applicable to energy commodities financing transactions.

For instance: Table 7, Counterparty data: fields 14 to 20.

Table 8, Transaction Data: Field 9, 22, 33, 35 to 38

Table 9, Collateral data: field 5 to 15.

It is worth recalling especially on collateral that non-financial counterparties below the clearing threshold under EMIR have been excluded from the obligation to report collateralisation because it is a disproportionate operational requirement.

Q58. Could all scenarios described for securities lending, repo and buy/sell back theoretically apply to future forms of commodities financing transactions?

No comment.

Q59. Should other scenarios be considered? If yes, please describe.

No comment.

Q60. Would you agree that the ISIN could be used to uniquely identify some commodities used in SFTs? If yes, which one and what prerequisites would need to be fulfilled? If no, what alternative solution would use propose for a harmonised identification of commodities involved in SFTs?

Our understanding is that the ISIN code is used to identify *derivatives* and other securities, hence it is likely to be irrelevant if the underlying of an SFT is a *commodity* rather than a *commodity derivative.*

Q61. Would the classification as described in RTS 23 of MiFIR be the most effective way to classify commodities for the purposes of transparency under SFTR?

We believe that the classification described in RTS 23, especially concerning natural gas, is missing many market areas for all countries different from Germany, Netherlands and the UK. We also wonder the reason for an approach at market area level for gas, whilst for electricity market areas are not considered to be relevant.

Q62. Is there another classification that ESMA should consider?

No comment

Q63. Are there transactions in which a pool of commodities is financed that the reporting needs to take into account? Please provide concrete examples.

No comment