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EFET Response to the Discussion Paper on the Clearing Obligation under EMIR

12 September 2013

A. Respondent

<u>Name:</u> European Federation of Energy Traders (EFET)
<u>Country:</u> Representing more than 100 energy trading companies, active in over 27 European countries
<u>Category:</u> please use the table below

Category	Please select
Audit/Legal/Individual	
Banking sector	
Central Counterparty	
Commodity trading	
Government, Regulatory and Enforcement	
Insurance and Pension	
Investment Services	
Non-financial counterparty subject to EMIR	x
Regulated markets/Exchanges/Trading Systems	
Other Financial service providers	

B. Introduction – General comments

EFET welcomes the opportunity to comment on this Discussion Paper on the Clearing Obligation under EMIR in view of the preparation of the regulatory technical standards, as required under Article 5(2) of the Regulation (EU) No 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories (EMIR).

C. Comments on the discussion paper and answers to questions

1. Procedure for the determination of the classes to be subject to the clearing obligation

In general, we approve the overall approach of ESMA laid out in points 23 to 26 to define the level of granularity of the sub-asset classes. Nevertheless, we wish to warn ESMA against dividing up sub-asset classes without having substantial rationale for such a breakdown. The breakdown into sub-asset classes will likely lead to an greater risk of error, and will increase the burden of clearing administration. Thus, the creation of a sub-asset class needs to be carefully considered.

Characteristics describing the sub-asset classes are important in order help market participants making the right identification (and breakdown) of OTC derivatives. However, the more characteristics used to define a class, the more limited the class will be. An excessive level of detail may lead to an unsustainable level of granularity of sub-asset classes.

2. CCP-cleared classes of OTC derivatives

2.5. Commodity derivatives

We have added in red the CCPs that have been omitted ant that have sent CCP applications to ESMA.

Commodity class num.	Commodity class name	Product type	Product sub type	Underlying asset	Settlement currency	Settlement type	Transaction type	CCP clearing
5	Energy – Coal	Energy	Coal	-	USD	Cash	Forward/Swap Option	LCH.clearnet Ltd ICE clear Europe CME clearing US
6	Energy – Electricity	Energy	Electricity	-	EUR, GBP	Cash, Physical	Forward/Swap, Options, CFD	MEFF Nasdaq OMX OMI Clear ECC ICE clear Europe
9	Energy – Natgas	Energy	Natgas	-	EUR, GBP	Cash, Physical	Forward/Swap, Options	MEFF Nasdaq OMX ECC ICE clear Europe
10	Energy – Oil	Energy	Oil	-	EUR, USD	Cash	Forward/Swap, Options, CFD	CME Clearing Europe LCH.clearnet Ltd. ICE clear Europe
11	Energy – Petrochemicals	Energy	Petrochemicals	-	USD	Cash	Forward/Swap Option	CME Clearing Europe ICE clear Europe
12	Energy – Refined	Energy	Refined Products	-	EUR, USD	Cash	Forward/Swap Option	CME Clearing

	Products							Europe ICE clear Europe
13	Environmentals – Emissions	Environmentals	Emissions	-	EUR	Cash, Phyiscal	Forward/Swap Option	Nasdaq OMX ICE clear Europe ECC
14	Freight	Freight	Freight	-	USD	Cash	Forward/Swap Option	CME Clearing Europe LCH.clearnet Ltd. ICE clear Europe Nasdaq OMX (NOS)

Question 16 (Commodity derivatives):

What is in your view the best approach to specify the underlying assets within each OTC Commodity class?

Answer 16:

EFET believes that the rules to be adopted by ESMA should rely on standards developed by the industry and widely used across jurisdictions. The use of, for instance, the ISDA or CpML taxonomy would allow market participants to achieve swifter compliance with the rules developed by

ESMA and reduce implementation costs as market participants use systems based on such industry standards.

Question 17 (Commodity derivatives):

Do you consider that the main characteristics of the Commodity derivatives are adequately captured by the proposed structure? Are there any other variables which you consider as relevant in the context of the clearing obligation?

Answer 17:

The proposed classification of energy related derivatives is broken down into fairly restricted fields without obvious justification. Before we can confirm what the best approach is to specify the underlying assets within the relevant OTC Commodity classes, we would need to know more about the background for the proposed sub-assets classes by ESMA.

Some sub-classification may also lead to confusion and misinterpretations etc. As an example, despite the footnote it is not clear how 'Agriculture - Biofuel' and 'Energy - Biofuel' will be differentiated. Further, it is unclear how the categories 'Energy - Inter Energy', 'Energy - Ferrous Metal' and 'Energy - Petrochemicals' will be differentiated from 'Energy - Refined Products'.

ESMA should work with the industry to examine characteristics for clearing based on Product Location, Delivery Method and Tenor to ensure that mandatory clearing is fully aligned with the availability of suitable instruments in the market.

Where firms are hedging their underlying risk with OTC derivative products, pricing and selection of the appropriate instrument is often underpinned by the value of the instrument closest in location to the commodity being hedged. Similarly the method of delivery is often specified within the offered instrument. Tenor can have a significant effect on the liquidity of instruments available for clearing. Spreads widen considerably down the curve in some products which will affect execution capability - although this can also be said to be true of the OTC markets as well.

For electricity products the maturity and the country should also be included as additional criteria.

Question 18 (Commodity derivatives):

Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

Answer 18:

Two aspects can be looked at when trying to identify the best candidates for the clearing obligation:

- on the one hand, clearing ratios (in comparison to OTC only) are increasing progressively. Emissions have got the highest share cleared. Electricity, oil and freight have more than 50% cleared so they could be further advanced. At the end of line are gas and coal, where most of the market is broker driven thus making the clearing effort much harder;
- on the other hand, coal and oil are the markets where there is the most liquidity which somehow makes them more mature.

Commodities as an asset class has consistently increased cleared volumes over the years as a response to managing counterparty credit risk, there is therefore some depth and liquidity in certain areas of the market, predominantly where products have been standardised and the commodity is widely traded e.g. Oil, Power, Gas.

As suggested in the Discussion Paper, there is a significant number of products which are defined for clearing and show sufficient liquidity – these logically lend themselves as suitable to be at the forefront of the clearing obligation. Subsequently a programme of identifying underlying products which can be standardised should be followed, prioritising those which are viewed to have greater systemic risk.