

European Securities and Markets Authority
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Comments of EUROGAS on the consultation paper on Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories

EUROGAS welcomes the opportunity to respond to the consultation by the European Securities and Markets Authority (ESMA) on its Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories. We have limited the scope of our response to this consultation to the sections of the document that are most relevant for EUROGAS members. We have also abstained from commenting on each question in detail to leave room for more in-depth remarks from individual companies.

EUROGAS key concerns are summarised as follows:

- We appreciate that ESMA has partly addressed our concerns with regard to the definition of hedging (by also including proxy hedging) and the clearing threshold (by raising the level of the clearing threshold to a more acceptable level). **We do however believe that the approach whereas crossing a threshold in one asset class would trigger clearing (and thus margining requirements) in all other asset classes and for other entities as well should be reconsidered.** We would suggest ensuring that crossing the threshold in one asset class would only trigger clearing of the transactions relating to that specific asset class. In this manner, the speculative activities of companies would be included under EMIR, without putting an additional and unnecessary burden on commercial foreign exchange and treasury activities.
- We welcome the proposals made by ESMA to clarify the definition of hedging through accounting rules and in technical standards. We however believe that due consideration should be given to the fact that any transaction should not be considered individually but in combination with other contracts, and that the objective of such transaction is to reduce a risk of change in value. In addition, accounting rules should not prevail on the economic logic of the transaction but rather reflect economic or commercial purposes.
- We also welcome ESMA's approach to recognize local GAAP as one of the means non-financial counterparties could use to define contracts objectively reducing risks related to commercial or treasury financing activities (ANNEX II of the technical standards). However we believe that this approach should be included rather in the criteria for establishing which OTC derivative contracts are objectively reducing risks than only in the recitals of the technical standards in order to strengthen this option.
- Although ESMA has chosen for a threshold that is based on a gross figure, **EUROGAS believes that basing the clearing threshold on a netted figure would be a more suitable solution.** Such an approach is not only more representative of the risk carried by firms, but also better reflects the wording in Article 10 (4) (b) of EMIR, where it is explicitly stated that the clearing threshold "shall be determined taking into account the systemic relevance of the sum of net positions and exposures [...]".
- If ESMA nevertheless decides to set the clearing threshold on a gross notional value, it is crucial that it is set at a level that reflects the high notional value of commodity derivative contracts compared to other asset classes and that is commensurate with a level of systemic risk. At the moment it is not proven – or at least reasonably argued by ESMA – why companies above a level of 3 billion euro are systemically important and thus should be captured by the clearing threshold. If the threshold is not set at a level that reflects systemic

importance, also non-systemically important parties will be captured. The additional cost and liquidity constraints that are triggered by mandatory clearing will result in less market liquidity on traded markets, less competition, less room for investments in new generation capacity, higher dependency on financial markets and in the end higher systemic risk. **EUROGAS is therefore of the opinion that ESMA should base the level of the clearing threshold on real transaction data that will be gathered under the EMIR reporting requirements.**

- **We therefore support ESMA's intention to review the clearing thresholds on a regular basis.** Such reviews should take into account commodities price inflation (for the commodities derivatives threshold), and the overall growth of the global OTC derivatives market (to continue reflecting appropriate systemic levels). Also, any change in the definition of financial instrument that might occur under MiFID II should trigger a revision of the thresholds and this should include also an open consultation with market participants.
- In order for market parties to be able to adequately assess the impact of EMIR **it is crucial to know which derivative contracts are in- and out of scope of the regulation** and precisely which transactions count towards the clearing threshold. Although we understand that the final scope of EMIR is dependent on the revision of the Markets in Financial Instruments Directive (MiFID) and specifically on the definition of financial instrument, we encourage ESMA to already now give more clarity on the scope of EMIR and the proposed Regulatory Standards, to avoid any misunderstandings on the matter. In this respect the following should be excluded:
 - Any transaction objectively measurable as reducing commercial risk
 - Any transaction that is not defined as a financial derivative transaction under MiFID. This also implies that physical forwards are excluded.
 - Any intra-group transaction once the general exemption for such transactions, which are not objectively measurable as reducing commercial risks, has been granted
 - Any transaction that has already been subject to central clearing – as such a transaction does not give rise to any additional credit risk and therefore is irrelevant for the purpose of assessment against the clearing threshold
- With regard to risk mitigation requirements for non-cleared contracts, we note that ESMA is proposing a set of measures that could help to reduce (counterparty) risk for un-cleared trades. We do support measures that can help reduce risk in the market, as long as they do not duplicate existing effective mechanisms (such as existing EFET and ISDA agreements). **We therefore recommend not to duplicate existing arrangements for risk mitigation of non-cleared contracts.**
- Specifically on ESMA's proposed confirmation period of two days for non-financial companies not exceeding the clearing threshold, we believe that this is still too ambitious. While non-financial companies are in many cases able to confirm their trades quite quickly, the length of the confirmation process heavily depends on i) the sophistication of the counterparty, and ii) the specifics of the transaction. **We therefore recommend extending the confirmation period for non-financial companies to four business days after the execution.**¹
- **Intra-group transactions that are objectively measurable as reducing risks do not have an effect on the market and should therefore be more clearly excluded** from both counting towards i) the clearing threshold, ii) any requirement for clearing in the event a non-financial firm breaches the threshold, iii) any reporting requirements and iv) any additional risk mitigation requirements. Although part of the draft regulatory standards for intra-group transactions still has to be drafted by EBA, EIOPA and ESMA it should be avoided that these transactions are made subject to several EMIR requirements without actually improving market functioning or reducing (systemic) risk.

¹ ESMA should also take into consideration that the confirmation of more complex and non-standardised product transactions cannot be processed in the above mentioned time period, because of 'long confirmations', additional (not initially mentioned) legal terms included in the confirmation, or involvement of different departments within a company. For these transactions, the confirmation will take five to ten business days without becoming undue. For these contracts the technical standards should stipulate that the confirmation should include only the essential (economic) conditions of an OTC derivative contract within the prescribed confirmation period. These economic terms are generally exchanged by the counterparty in order to value the derivative trade, as equivalent to the full confirmation. Complete transaction details can subsequently be kept on record by the counterparties and can be submitted upon request.

- EUROGAS welcomes the fact that ESMA has provided a detailed proposal on the overview of the fields to be reported within the transaction reporting regime. It is however crucial to outline that this detailed proposal needs to be further discussed and defined for content and format, taking into account the specifics of the energy and commodity sector. A full comparison to the transaction reporting details applied under other regulations (in particular REMIT & MiFID) is necessary to reduce the operational burden for reporting parties and make the implementation efficient. **We therefore strongly support an approach where ESMA closely aligns its reporting scheme with ACER and ensures a sufficiently detailed set of specifications.**
- It is of vital importance that ESMA allows sufficient time for implementation of EMIR obligations. In terms of implementation timing, the requirements introduced by EMIR will have a substantial impact on the business practices of non-financial entities dealing with financial derivatives. In order to adjust processes and implement highly complex IT infrastructure modifications in time, companies require flexibility in the implementation period. The text under consultation is missing sufficient details of concrete implementation planning, and the tight timeline forces to draft implementation plans with a high regulatory risk. **We therefore invite ESMA to increase the level of involvement of stakeholders in the definition of the implementation phase and to quickly communicate a more concrete timeline and implementation guidance.**