European Securities and Markets Authority

Response form for the Consultation Paper on post trade risk reduction services with regards to the clearing obligation (EMIR Article 85(3a))

27 March 2020

European Securities and Markets Authority

Date: 27 March 2020

Responding to this paper

ESMA invites responses to the questions set out throughout its Consultation Paper on the Report on post trade risk reduction services with regards to the clearing obligation that ESMA is drafting under Article 85(3a) of the Regulation (EU) No 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories (EMIR, as amended by Refit).

Responses are most helpful if they:

- respond to the question stated;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all responses received by **15 June 2020**.

Instructions

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

- Insert your responses to the questions in the Consultation Paper in the present response form.
- Please do not remove tags of the type <ESMA_QUESTION_PTRR_1>. Your response to each question has to be framed by the two tags corresponding to the question.
- If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
- When you have drafted your response, name your response form according to the following convention: ESMA_PTRR_nameofrespondent_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA_PTRR_ABCD_RESPONSEFORM.
  - Upload the form containing your responses, **in Word format**, to ESMA's website (www.esma.europa.eu under the heading "Your input – Open consultations" → "Consultation Paper on post trade risk reduction services with regards to the clearing obligation (EMIR Article 85(3a))".

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. **Please clearly indicate by ticking the appropriate checkbox on the website submission page if you do not wish your contribution to be publicly disclosed.** A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading “Data protection”.

Who should read the Consultation Paper

All interested stakeholders are invited to respond to this consultation paper. In particular, responses are sought from financial and non-financial counterparties of OTC derivative transactions as well as central counterparties (CCPs) and clearing members.

General information about respondent

Name of the company / organisation	European Federation of Energy Traders (EFET)
Activity	Other Financial service providers
Are you representing an association?	☒
Country/Region	Europe

Introduction

Please make your introductory comments below, if any:

<ESMA_COMMENT_PTRR_1>
TYPE YOUR TEXT HERE
<ESMA_COMMENT_PTRR_1>

Q1 : Would you agree with the description of the benefits (i.e. reduced risks) derived from PTRR services? Are there any missing? Could PTRR services instead increase any of those risks? Are there any other risks you see involved in using PTRR services?

<ESMA_QUESTION_PTRR_1>
While EFET supports the promotion of portfolio compression, we would like to underline that compression exercises remain marginal for energy trading NFC- , which make most of our membership. The reasons thereof are:

- Potential tax implications pertaining to the compression of transactions between 2 counterparties established in different jurisdictions, where there might be absence of clarity on the VAT treatment of the compressed transactions;
- One directional OTC derivatives trading where one party is always acting as seller / buyer to the other party in all transactions;
- Use of other methods that are more common to NFCs to reduce counterparty credit risk such as entering into offsetting transactions to net gross exposures;
- Risk or portfolio management considerations which allow for a compression exercise to be waived;
- Portfolio compression exercises may also represent an operational risk as they affect existing deals and their construct, which would outweigh the benefits of compression.

EFET would at this stage want to highlight the possibility to reduce systemic risk through involvement of a CCP. Voluntary clearing of OTC derivatives by counterparties would de facto reduce counterparty risk and enhance transparency and robustness of markets. This method is in addition more easily available to NFCs and its use could be more widespread with the right regulatory incentives. To foster voluntary clearing for instance, EFET would welcome the precision that:

- The cleared transaction terminates and replaces the OTC derivative transaction – which is a legal consequence attached to clearing as the CCP replaces both parties respectively in the execution of the relevant side of the transaction; and
- The OTC derivative transaction, due to its termination, does not any longer count against the clearing thresholds.

A clarification of ESMA's Q&A, OTC question 1(d) would be required in this regards.

TYPE YOUR TEXT HERE
<ESMA_QUESTION_PTRR_1>

Q2 : Would you agree with this description of portfolio compression? Please explain the different compression services that are offered and how they may differ from the description above. Are there today viable alternatives to using PTRR services to achieve a similar outcome?

<ESMA_QUESTION_PTRR_2>
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<ESMA_QUESTION_PTRR_2>

Q3 : Without changing the market risk of the portfolios, how different can the transactions included in the portfolio compression exercise be? Would the market risk be changed at all by the applied tolerances and if yes, how can the portfolio remain market neutral? What tolerance levels are often applied and could/should restrictions be placed on tolerances?

<ESMA_QUESTION_PTRR_3>
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<ESMA_QUESTION_PTRR_3>

Q4 : Should there be a clearing exemption for PTRR trades that are a direct result from a portfolio compression? If not, why? Is there a difference between bilateral and multilateral portfolio compression for the sake of an exemption?

<ESMA_QUESTION_PTRR_4>
To encourage PTRR exercises, EFET believes that the transactions resulting from the compression should indeed – where operationally feasible - benefit from a clearing exemption.
TYPE YOUR TEXT HERE
<ESMA_QUESTION_PTRR_4>

Q5 : Would you agree with this description of PTRR Services? What other forms of PTRR services exist? What do they do? How do they work? Are there any other viable alternatives to PTRR services, if yes, why are they not sufficient?

<ESMA_QUESTION_PTRR_5>
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Q6 : Without changing the market risk of the portfolios, how different can the transactions included in the PTRR exercise be? What tolerance levels are often applied and what restrictions could/should restrictions be placed on tolerances (if applies)?

<ESMA_QUESTION_PTRR_6>
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Q7 : Is the requirement under EMIR of portfolio compression sufficient to mitigate the risk of build-up of transactions and how is the market managing this risk today?

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Q8 : Based on all of the above, how would you define (algorithm based, second order risk, market neutral) PTRR services that cover all of the relevant aspects?

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Q9 : Should there be an exemption from the clearing obligation for PTRR trades (other than portfolio compression) that are a direct result from a PTRR exercise? If not, why?

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<ESMA_QUESTION_PTRR_9>

Q10 : Is there a PTRR service today including offsetting transactions with a CCP?

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Q11 : Assuming there would be an exemption to the clearing obligation:

(i) Could PTRR services conduct offsetting opposite trades in the counterparty's cleared portfolio and if yes, should it be mandatory to enter into such offsetting transactions?

(ii) Would the PTRR transaction in the non-cleared portfolio then remain between the counterparties or be terminated (netted)?

<ESMA_QUESTION_PTRR_11>
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Q12 : Please provide data (number of trades and notional compressed, amount of initial margin reduction, number of counterparties regularly using PTRR services, other metrics) per type of PTRR service, with as much granularity as possible (per entity, per asset class/currency, per run, over the years and over the past year, etc.) and the related explanations on how PTRR services are used.

<ESMA_QUESTION_PTRR_12>
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Q13 : Please also, where possible, provide data whether those numbers would be expected to change if there was an exemption to the clearing obligation.

<ESMA_QUESTION_PTRR_13>
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Q14 : Do you think an exemption from the clearing obligation for transactions resulting from PTRR services would increase the use of PTRR services? Please explain.

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<ESMA_QUESTION_PTRR_14>

Q15 : Do you think an exemption from the clearing obligation is not needed for legacy portfolios and PTRR services generally? To what extent can the use of plain vanilla transactions in PTRR services be replaced with the use of non-plain vanilla transactions, or should this be avoided? Please explain.

<ESMA_QUESTION_PTRR_15>
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Q16 : Would an exemption to the clearing obligation contradict the G20 commitments? Please explain.

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Q17 : How could an exemption to the clearing obligation for PTRR trades lead to a circumvention of the clearing obligation? Please explain.

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Q18 : Would you consider introducing an exemption to the clearing obligation as an incentive not to clear transactions that technically are covered by the clearing obligation. If yes, why?

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<ESMA_QUESTION_PTRR_18>

Q19 : Are there risks with reducing collateral? Even if complying with regulatory requirements, could this lead to such capital being used to increase risks, possibly systemic risks?

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Q20 : Are there other jurisdictions where PTRR trades have been exempted from the clearing obligation? Please explain the features of any such exemption. Do you use any of those exemptions, and for what type of trades?

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Q21 : Should conditions, similar to the ones as outlined above, apply to a possible exemption under EMIR for PTRR transactions? Should other conditions apply? Would the answer depend on the type of PTRR service? Please explain.

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Q22 : Is there a difference between bilateral and multilateral portfolio compression justifying an exemption to the clearing obligation only to apply for multilateral portfolio compression?

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Q23 : Should only uncleared transactions be included in portfolio compression in order to qualify for the clearing exemption? How would a possible limitation to uncleared transactions limit the effectiveness?

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Q24 : To benefit from an exemption to the clearing obligation, should PTRR trades be strict risk neutral or should there be tolerances for small changes in the risk of portfolios? How would you define what is an acceptably small change in risk?

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Q25 : To benefit from an exemption to the clearing obligation, to what extent should parties to a PTRR exercise be able to be changed, i.e. not limited to the original counterparties? Would the answer depend on the type of PTRR service? Please explain.

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Q26 : Should there be a requirement for PTRR services to reduce risk for a clearing exemption to apply? Should it apply to all PTRR services? If not, please explain why. How would a successful PTRR exercise be measured?

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Q27 : Could PTRR services increase exposure or risk on a participant basis? Would the answer depend on the type of PTRR service provided? How should the PTRR service provider limit any possible increase in notional amount or risk? Please explain.

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Q28 : How could a limitation like "no participant worse off" be defined?

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Q29 : How should it be ensured that PTRR service providers are independent in their assessment? Should the conditions imposed on the providers of PTRR services include requirements on governance of the algorithms to ensure the definition and the setting of parameters takes place with minimum influence from market participants? Should algorithms run with minimum manual intervention? Any other conditions or structural requirements that should apply?

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Q30 : Do you consider that a PTRR service provider should be specifically licenced or authorised? Would this depend on the remits of the services provided? Would it be sufficient to provide requirements on the service provided, i.e. on transaction level rather than entity level? What do you see as the benefits of regulating PTRR services? Would this create any impediment or barriers?

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Q31 : What would be the cost-benefit of exempting PTRR transactions (replacement and risk mitigation services through offsetting trades such as rebalancing) from the clearing obligation?

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