EFET European Federation of Energy Traders
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Amstelveenseweg 998
1081 JS Amsterdam

+31 20 520 7970
secretariat@efet.org
www.efet.org

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The EU Commission responded in their letters to the EFET and other associations that "*EU equivalence decisions are unilateral and adopted only if it is in the interest of the EU*". It is the industry's understanding that at this stage the EU Commission does not intend to grant equivalence under EMIR Article 2a to the UK commodity exchanges ICE and LME.

In practice, the non-equivalence under Art. 2a of EMIR and re-characterisation of derivatives traded on non-equivalent UK venues as OTC derivatives expose EU non-financial firms to the risk of rapidly exceeding the EMIR clearing threshold for EUR 3bn for commodities (EMIR CT) during the current EMIR CT calculation period until end of May 2021. The consequence of this risk is that EU non-financial firms face an immediate stark choice between meeting costly and burdensome NFC+-EMIR requirements or restricting their trading activities on UK exchanges to avoid breaching the EMIR CT, due to lack of alternative similar venues for trading. This situation places EU non-financial firms at a competitive disadvantage when compared to 3rd country firms and this solely based on a regulatory necessity for EU firms to avoid breaching the EMIR CT. Ultimately, the alternatives of implementing the NFC+ status or avoiding it by reducing trading activities on ICE and LME will increase costs for the industry and cause higher power and gas prices for consumers. These and other material adverse consequences are explained in further detail in this letter and its Annex 2 and 3.

Consequentially, it is the EFET members' view that the significant negative impacts resulting from this EMIR Article 2a non-equivalence with respect to the UK exchanges ICE and LME require immediate action:

EFET is of the opinion that **transactions entered on ICE and LME since January 2021 should not account for the calculation against the EMIR clearing threshold of EUR 3bn for commodities** ("EMIR CT") for the following reasons:

- **The competitive disadvantage for EU NFCs and the wider EU economy could be mitigated.** Trading on ICE and LME can result in a EMIR CT breach triggering immediate compliance obligations with extensive NFC+ requirements under EMIR. Consequently, EU NFC wishing to remain below the EMIR CT have to limit or event stop their trading activities in these markets. This results in a material competitive disadvantage for EU NFC when compared to 3rd country firms and increases costs for the wider EU real economy and, ultimately, for end-consumers in the EU. These adverse consequences are explained in more detail in this paper and Annexes 2 and 2.
- **EU NFCs would not be restricted in their access to the most liquid pools for certain commodity derivatives.** ICE and LME are the most liquid pools for all EU Emission Allowances (EUA), LNG, gas, metals, oil and all other commodity products listed on these venues. Alternative trading venues with a comparable product offering and liquidity do not exist making ICE and LME the commercially most attractive venues. It is important to understand that unrestricted access to these markets is required for efficient hedging of long-term supply contracts such as gas and

LNG, both of which are often indexed to oil. Hence, EU NFCs depend on the access to ICE and LME to efficiently trade and hedge in these commodity derivatives.

- **Relief for the EMIR CT resulting from migration of trading in these products to the EU or 3rd countries is unlikely to happen**. ICE and LME have no intention to migrate to the EU as their commodity markets are international markets. ICE will migrate only the EUA trading to ICE Endex by June 2021. The reason is that from the perspective of ICE and LME, the EU NFCs only account for a small amount of the market share which is why there is no advantage for the exchanges to transfer further business to the EU. For the same reason, it is unlikely that sufficiently liquid pools for ICE and LME traded commodity products will be established in the EU. Market participants usually choose the most liquid trading venue and the only market participants with a viable interest to shift liquidity to the EU are EU NFCs which – again – only account for a small amount of the market share. The dominant international market participants have no interest in a migration to the EU for two main reasons: These participants, including UK energy firms, are not affected by the disadvantages resulting from EMIR and a migration to the EU would only lead to scattered liquidity which is not beneficiary for these participants. Consequently, any attempt to list (Euro de-nominated) similar commodity contracts on an existing EU commodity exchange would fail. The same holds true for any attempt to migrate liquidity to any 3rd country exchange. Currently, 3rd country exchanges, like the CME in the US, don't offer sufficient liquid market places.

The underlying reasons and – in particular – the negative consequences for EU NFCs can be further described as follows:

1. **Unfettered access to trading on ICE and LME raises no concerns from a regulatory or operational /credit risk perspective.**

   a) **It is against the policy aim of EMIR to negatively affect trading of centrally cleared derivatives on orderly regulated exchanges such as ICE and LME**

   - The EMIR CT was designed to address operational and credit risks of bilateral, non-centrally-cleared OTC derivatives trading, or trading on truly non-equivalent third country trading venues. These risks are fully mitigated when trading on the orderly regulated ICE and LME venues as these derivatives traded on these venues are centrally cleared through their CCP. Hence, this trading activity should not be affected by the EMIR CT.

   - It was neither the intention of the EU legislator nor does it make sense from a risk management perspective that centrally cleared derivatives traded on an equivalently regulated exchanges should trigger the breach of the EMIR CT.

   - To account these derivatives for the EMIR CT is even contrary to the policy aim of EMIR as it creates a disincentive for NFCs to comply with the policy objective to trade on centrally cleared exchange markets.

   b) **ICE and LME are equivalent in the meaning of Article 2a of EMIR. The exchanges and their clearing houses have the same functionalities like EU exchanges and are currently regulated in an equivalent manner to EU Regulated Markets:**

   - Granting equivalence to ICE and LME would only be reasonable as the conditions of Article 2a of EMIR are fulfilled. Commodity exchanges and their clearing houses based in the UK are regulated equivalently. Until recently they were directly subject to all

relevant EU legislation and remain subject to these underlying rules as the UK has transposed the EU legislation 1:1 into its national laws.

- Consequently, the EU Commission would be able to grant equivalence to ICE and LME. Not granting equivalence in this context appears as a rather arbitrarily political decision for which no real justification is available other than to force re-location of commodity trading into the EU. The resulting major competitive disadvantages for EU NFC need to be mitigated in an appropriate manner.

- Moreover, the EU Commission has even granted equivalence to e.g. exchanges based in the U.S. or Singapore, which are subject to different set of local rules.

- Finally, the UK has granted equivalence to EU exchanges already so that mutual recognition would be appropriate.

2. EU NFCs face the risk of rapidly exceeding the EMIR CT after having voluntarily complied with the intended policy aim of EMIR

a) EU NFCs voluntarily complied with the intended policy aim of EMIR to foster trading on Regulated Markets such as ICE and LME

- In line with the overall policy aim of EMIR to mitigate operational and credit risks, EU NFCs voluntary moved their OTC trading activities to these trading venues.

- Not in line with this overall policy aim, due to a pure literal application of EMIR and resulting from political reluctancy to grant equivalence to these exchanges, the exchange-traded commodity derivatives entered on ICE and LME from January 2021 have to be treated as OTC Derivatives and thus contribute to the EMIR CT.

b) EU NFCs face the risk of rapidly exceeding the EMIR CT

- In practice, the non-equivalence under Art. 2a of EMIR and re-characterisation of derivatives traded on non-equivalent UK venues as OTC derivatives expose EU NFCs to the risk of rapidly exceeding the EMIR CT during the current EMIR CT calculation period until end of May 2021.

- **EU NFCs can only use ICE and LME markets as only these trading venues offer sufficiently liquid markets in certain commodity products and, hence, their exposure to the EMIR CT builds up rapidly, even before the end of the current EMIR CT calculation period until May 2021.**

- In addition, other OTC derivatives transactions continue contributing to the EMIR CT as well and for EU NFCs seeking to hedge their commodity risks it is traditionally these derivatives that represent the provision of important hedging solutions for industrial and commercial customers. Consequently the provision of this hedging liquidity is also at risk.

- Asset classes and contracts that contribute to the breach and for which no alternative liquid trading venue is available are in particular EU emission allowances, coal, LNG, metals, oil, but also other contracts. Please see **Annex 1** for the concerned contracts.

- **The hedging exemption and amended calculation method (Art. 10 EMIR REFIT) do not prevent NFCs from breaching the EMIR CT,** because the hedging exemption does not

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cover all trading activities on LME and ICE, *e.g.,* as hedging is limited to specific risk reducing activities covering eligible underlying commercial activities only. Consequently, e.g. all risk reducing transactions with financial or speculative underlying do not fall under the hedge exemption. Furthermore, firms perform other activities than hedging on these exchanges as previously those exchange-traded transactions did not count against the EMIR CT.

3. Impact of non-recognition of ICE and LME: immediate, costly and burdensome compliance requirements only affect EU NFCs and without sufficient time to prepare and implement

EU NFCs belonging to industrial groups which breach the EMIR CT **(NFCs+) will have to comply immediately with costly and burdensome EMIR risk management requirements** (Article 10 and 11 EMIR) following an EMIR CT breach in June 2021 and/or will have to **start immediately the implementation of these requirements in case of a foreseeable EMIR CT breach in June 2022**.

Immediately applicable risk mitigation requirements encompass the following EMIR compliance requirements and impact all legal entities entering in derivatives of any asset class in a group breaching the clearing threshold:

a) **Bilateral collateralization** of non-centrally-cleared OTC derivatives through posting of **variation margin (VM)** immediately after the EMIR CT breach and **initial margin (IM)** upon the breach of the threshold under the Margin RTS (CDR 2016/2251). The cost of VM and IM can amount to more than **€ 1-2bn** per firm. This leads to trapped liquidity which EU NFCs can invest for example in economic sustainable activities which in turn is counterproductive for achieving the aims of the EU's Green Deal.

b) **Further risk mitigation techniques** such as timely confirmation deadlines, higher frequency of trade reconciliations, trade compressions and reporting requirements. This triggers as well to considerable implementation and ongoing cost.

c) The **implementation duration** for these requirements takes **at least 10-12 months**. Hence, NFCs can't implement the NFC+ status by June 2021 and will be able to be fully compliant only for the end of the next EMIR CT calculation period in June 2022.

The details of these risk mitigation requirements and involved compliance work/costs are described in more detail in the **Annexes 2 and 3** to this paper.

4. Impact of non-recognition of ICE and LME: stark choices for EU NFCs resulting in competitive disadvantages

a) Stark Choices for EU NFCs

The consequence of the non-recognition of ICE and LME is that EU NFCs face an immediate stark choice between

- **meeting costly and burdensome NFC+-EMIR requirements or**
- **restricting their trading activities on UK exchanges to avoid breaching the EMIR CT, due to lack of alternative similar venues for trading.**

Exceeding the EMIR CT after June 2021 requires full NFC+ Compliance by the end of the next EMIR CT calculation period (June 2022). To achieve this, they **must start now with** the costly and burdensome preparatory compliance work. This costly preparatory work could end up being redundant in case ICE and LME are being granted equivalence in due course. Switching back

from the newly acquired NFC+ status to the NFC- status would result in further costs for companies.

Not exceeding the EMIR CT during the next and following EMIR CT calculation periods requires a **permanent limitation of their trading activities** at ICE and LME.

In practice, EU NFCs are already impacted as they **are forced to stay below the EMIR CT** and thus have to limit their trading activities accordingly during this EMIR CT calculation period as they are unable to implement the NFC+ status on time by June 2021. **In fact, this means an immediate substantial or complete stop of trading activities for the concerned EU NFCs.**

b) Competitive disadvantages for EU NFCs

This situation places EU NFCs at a competitive disadvantage when compared to 3rd country firms solely based on a regulatory necessity for EU firms to avoid breaching the EMIR CT. The competitive disadvantages are manifold for the concerned firms, but also for the wider economy:

- EU27 real economy firms would lose unfettered access to the huge liquidity pools on UK commodity exchanges.
- In turn, it has and continues to reduce the liquidity on these exchanges which also negatively impacts the ability of EU NFCs, incl. the wider real economy, to hedge their commercial risk efficiently.
- Additionally, liquidity of OTC markets is reduced, as NFCs use the EMIR CT headroom already for the ICE and LME trading activities and, hence, cannot provide liquidity on OTC commodity derivatives markets anymore. The EMIR CT of EUR 3bn was set at that non-systemic relevant level to enable EU NFCs to provide liquidity to OTC markets. Consequently, market participants such as industrial producers, in particular those with no access to exchanges, will find it more and more difficult to find a counterparty willing to provide them OTC hedges.
- Reducing trading activities means in practice a considerable loss of opportunities for the concerned firms and/or lead to the permanent closure of trading activities and hence job losses in the EU.
- NFCs established in 3rd jurisdictions do not encounter the above-mentioned stark choice, as other jurisdiction do not have such formal equivalence requirement in place or do recognize EU exchanges as equivalent. For example, the UK market participants continue to have an unfettered access to EU commodity exchanges as the UK recognized EU commodity exchanges as equivalent.

Ultimately, the alternatives of implementing the NFC+ status or avoiding it by reducing trading activities on ICE and LME will increase costs for the industry and higher power and gas prices for consumers.

5. ICE EUA Positions – The transfer of EUA positions to the EU should lead to a regulatory reclassification

ICE has announced that on the 7th June it will transfer the execution of its emissions market to its EU Regulated Market located in the Netherlands (ICE Endex).

ESMA should clarify that EUA positions do not contribute to the EMIR CT anymore now they are transitioning to the EU. Positions that are transitioning to the EU should be treated in the same way as new EU exchange traded transactions entered over ICE Endex which clearly do not contribute to the EMIR CT. The above arguments are particularly valid for the EUA markets in transition. In addition, the following should be taken into account:

- For the purpose of the transition it is vital that a prudent approach is followed to ensure that this emissions market remains orderly, deeply liquid and continuously accessible to all firms. EU-wide measures at supervisory level necessary are necessary to facilitate an orderly transition which preserves liquidity, allowing undisrupted prices signals to be provided to the wider European economy which are crucial in the context of the EU's climate change ambitions and the energy transition.
- EU-based firms require access to deep liquidity pools that venues based in the EU currently do not offer. The screen liquidity and tight bid-offer spreads of ICE's EUA contract is unequaled. Obstructing access to this liquid order book during its transition to the EU will frustrate EU firms' ability to meet compliance obligations under the EU ETS and will substantially increase the cost of trading.
- A new regulatory evaluation encompassing EMIR is required as only in this way a consistent approach with MiFID could be achieved. Under MiFID and the respective position limit regimes, a transfer of contracts to an exchange based in a different country results in the position limit regime of this new country being applicable to the respective contracts.
- Another reason why these EUA Positions should not be seen as EMIR relevant anymore once transferred to ICE Endex lies within the way of the transfer taking place. For the purpose of transitioning the contracts will be removed from trading on ICE UK and will then transition to ICE Endex. This removal and transitioning of the contracts to an exchange based in the EU requires a new regulatory evaluation. This is supported by the way ICE treats these contracts – once transferred they are treated as positions in the Endex contracts.

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