



### Targeted changes to EMIR rules can support Europe's energy transition

- **Open, liquid and competitive wholesale energy markets are an essential enabler of energy sector decarbonisation**
- **Proportionate financial regulation facilitates the creation of liquid and competitive energy markets**
- **Independent analysis of international standards of OTC derivatives markets regulation shows there is an opportunity to enhance European competitiveness and improve market functioning, whilst safeguarding transparent and safe markets**
- **This is necessary as the EMIR clearing threshold discourages the EU-energy sector from providing liquidity to OTC markets and offering effective risk management opportunities. Liquid OTC markets would allow renewable energy producers to mitigate the commercial risks of their anticipated massive investments necessary for the energy transition**
- **We therefore propose a targeted amendment to the EU's regulation of OTC derivatives markets (EMIR) by increasing the clearing threshold for commodities to an internationally comparable level. This will support the development of EU wholesale energy markets and better facilitate the energy transition without compromising market integrity and stability**

#### Increasing the EMIR clearing threshold can facilitate the energy transition

Amending the EU EMIR rules relating to the clearing and margining obligation for EU non-financial firms would facilitate the energy transition by:

- 1) *Enabling more effective hedging* - By further enabling the development of open and competitive energy and commodity derivatives markets in the EU, it would enable energy firms to support the energy transition by providing liquidity to OTC markets and offering hedging opportunities to renewable energy producers and industrial consumers to reduce their commercial risks.
- 2) *Enhancing European competitiveness* - By aligning the EU regime with those in other jurisdictions, it would enhance the competitiveness of European firms and enhance the development of euro-

denominated energy and commodity markets. It is notable that the attached independent study on international best practice concluded that the EU EMIR regime applies the lowest clearing threshold applicable to the largest set of entities, products and activities.

- 3) *Ensuring high standards are maintained* - By safeguarding the EMIR goals of transparent and safe markets. Our proposed review adheres to the aims of EMIR to make derivatives markets more transparent, to mitigate credit risk and to reduce operational risks.

We therefore urge ESMA to review and increase the EMIR clearing threshold for commodities to a systemic relevant level, considering the higher level of clearing thresholds in 3<sup>rd</sup> country jurisdictions and lower breadth of application across these jurisdictions. This proposal means that only relatively simple amendments to the Level 2 text of EMIR<sup>1</sup> would be required.

For example, we would support an approach which aggregated the current individual clearing thresholds for different asset classes into a single clearing threshold in total of 11bn EUR for all asset classes.<sup>2</sup> This would align the European scheme with those in Australia (AUD 100bn), Singapore (SGD 20bn) and the United States (USD 8bn).

ESMA is required to perform such a review as the legislation foresees the need to periodically review, and potentially update, clearing thresholds to take account of any new development in financial markets.<sup>3</sup> Such new developments occurred based on the EU's Green Deal<sup>4</sup> and Sustainable Finance<sup>5</sup> agendas. These initiatives are intended to mobilise massive investments into sustainable economic activities to achieve the EU's 2030 energy and climate targets, and to become climate-neutral by 2050. A well-functioning financial sector is key to providing the targeted financing and investments into sustainable economic activities, including into renewable energy production.

### Open, liquid and competitive wholesale energy and commodity markets enable the energy transition

We believe that open, robust, liquid, competitive and transparent energy and commodity markets are key to ensuring secure, sustainable and competitive energy supply to the real economy and end consumers in Europe. Therefore, we fully endorse the EU's strategy to further support the development of euro-denominated commodity derivatives for energy and raw materials.<sup>6</sup> Well-functioning markets will allow market participants to effectively reduce the commercial risks they face by offering suitable products through exchanges and bilateral Over-The-Counter (OTC) markets at competitive conditions. Such wholesale energy and commodity markets will enable energy and other firms to invest in the decarbonisation of the European economy and to ultimately contribute to the European Commission's long-term goal of the "European Green Deal".

The energy transition will be led by energy market participants. Regarding renewable energy markets, firms use energy and commodity derivatives to mitigate the specific commercial risks triggered by their renewable energy production (i.e. hedging). Renewable energy producers can only hedge their

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<sup>1</sup> This means a change to Art. 11 of Regulation (EU) No 149/2013 ([link](#)), which ESMA can propose

<sup>2</sup> There are separate "clearing thresholds" NFCs for five product groups under EMIR: (i) credit (€1 billion); (ii) equity (€1 billion); (iii) interest rates (€3 billion); (iv) foreign exchange (€3 billion); and (v) commodity or others (€3 billion), which amount to €11 billion in total, see Article 11 of Regulation (EU) No 149/2013 ([link](#))

<sup>3</sup> Article 10(4) of Regulation (EU) No 648/2012 ("EMIR"; [link](#)); Recital 9 of EMIR REFIT Regulation (EU) 2019/834 ([link](#))

<sup>4</sup> Delivering the European Green Deal ([link](#))

<sup>5</sup> See Overview of Sustainable Finance ([link](#))

<sup>6</sup> Communication from the European Commission: *The European economic and financial system: fostering openness, strength and resilience*, COM(2021) 32 final, Brussels, 19.1.2021, pages 6 – 8 ([link](#))

commercial risks if they can enter into hedging transactions, i.e. if there are energy firms which are willing and able to offer suitable hedge transactions to them. However, the EMIR clearing threshold discourages these energy firms from providing liquidity to OTC markets and offering effective risk management opportunities to the renewable energy producers.<sup>7</sup>

This is particularly important for integrating renewable energy into the system as market participants use wholesale energy and commodity markets for many hedging purposes: Renewable energy producers need well-functioning markets to ensure they can sell the renewable energy they produce or import, for example, the sale of electricity production from wind parks, solar panels or hydrogen. Industrial customers need these markets to source energy from renewable sources at competitive prices in order to decarbonise their own production (e.g., cars, chemicals, steel). Wholesale energy markets will also support the development of nascent renewable energy markets such as hydrogen. For example, producers of green hydrogen need to have access to sufficient liquid pools of renewable power to generate green hydrogen. The price signal in functioning energy markets will demonstrate when it is efficient to sell electricity to industrial consumers, when it would be more efficient to charge a battery or when it would be better still to supply an electrolyser to produce green hydrogen. Furthermore, the manufacturing industry can procure the critical raw materials (e.g. metals) they need to manufacture renewable energy installations, such as windmills, solar panels or hydrogen installations.

While important for managing operational risk, wholesale energy markets are vital to supporting the colossal investments into the renewable energy infrastructures necessary for the energy transition, such as wind parks, solar installations and hydrogen infrastructures. Only liquid wholesale energy markets will enable EU and international market participants to make the foreseen investments of EUR 350 billion<sup>8</sup> per year over this decade necessary to meet the 2030 emission-reduction target for energy systems alone. The reason is that these environmentally sustainable activities carry long term market (price) risks which require corresponding long-term hedging opportunities which are achieved with energy and commodity derivatives. Such hedging, however, can only take place if there are counterparties which are willing and able to take these risks into their own books and to provide hedging opportunities for the other market participants such as renewable energy producers. The particular risks and frequent volatility in renewable energy markets often require hedging solutions that are non-standard (i.e. provided via the OTC market). These solutions can best be provided by active energy market participants with the expertise and portfolio size to manage the specific commercial risks involved and to price their hedging products accordingly. Therefore, liquid OTC derivatives markets are particularly well-suited to offering the tailor-made products that are necessary to guarantee the cost-effective management of the specific risks faced by renewable investors.

For example, the output of wind or solar parks depends on weather conditions, which can obviously change very quickly. Investors in these technologies face uncertainties about how much they will produce, when they will produce it and at what price. To manage these risks, they must be able to enter into tailor-made, bilaterally negotiated OTC hedging transactions with energy market participants. Thus, managing these risks relies on the presence of firms which are willing and able to provide tailor-made and structured risk management solutions in the form of transactions in OTC energy and commodity derivatives. For example, onshore and offshore wind generators enter into financially settled electricity swaps with particular price features to hedge their specific and complex market price risks. In addition, even for more standardized risk profiles the contracts in the OTC trading

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<sup>7</sup> See section “Potential adverse consequences for the energy transition” below

<sup>8</sup> See Communication from the European Commission: Strategy for Financing the Transition to a Sustainable Economy, COM (2021) 390 final, Brussels, 6.7.2021, page 1 ([link](#))

markets are the only hedging possibility simply because the exchanges do not offer the long-term contracts needed to match the long-term commercial risks of the sustainable energy assets in question (such as wind or solar parks). Finally, industrial consumers can enter into long-term (10-20 years) power purchase agreements (“PPA”) with renewable power producers or re-sellers of such renewable production. Often such a PPA is structured as a bilaterally negotiated OTC cash settled fix-for-floating swap, a so-called virtual PPA, which secures the renewable energy producer a fixed margin for its power quantities (hedging) and is combined with the delivery of the Guarantees of Origin (GoOs) to the industrial customer for his de-carbonization purposes.

### **Proportionate EU financial market regulation is key to facilitate the energy transition**

The goal of the EU’s financial market regulation is to enable the development of euro-denominated commodity markets for energy and raw materials which are open, competitive and attractive for EU and international market participants.<sup>9</sup> As explained above, such markets will enable market participants to mitigate the commercial risks of their renewable energy activities. This will encourage even greater levels of investment in renewable energy production and in the infrastructure required to implement the EU’s energy transition.

The EU Commission recognized in its recent communication<sup>10</sup> that EU financial markets need to remain attractive and competitive and, hence, stressed the importance of further developing energy and commodity markets. The adoption of the MiFID II quick fix text<sup>11</sup> is helpful as it enhances the proportionality of market rules for energy market participants. The applicable amendments to MiFID II should ensure that euro-denominated energy and commodity markets are able to foster and allow producers and manufacturers to effectively hedge their risks whilst safeguarding the integrity of commodity markets.<sup>12</sup>

Building on this helpful reform of commodity derivatives markets for energy, we are of the opinion that there are further steps which could be taken to enhance the proportionality of financial market regulation to ascertain how it can better help the development of energy and commodity markets and, hence, the EU’s energy transition.

### **Independent analysis of international standards of OTC derivatives markets regulation**

We have commissioned an independent assessment of international approaches to the regulation of OTC energy and commodity derivatives markets. This regulatory study compared the EU EMIR<sup>13</sup> rules with international standards for the clearing and margining obligations of non-financial firms (NFCs).<sup>14</sup> In this context, we paid particular attention to the fact that under the EU EMIR non-financial firms’ whose annual transactions are above a defined EMIR clearing threshold<sup>15</sup> (so-called NFCs+) become subject to mandatory central clearing and/or bilateral margining requirements.

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<sup>9</sup> Communication from the European Commission: *The European economic and financial system: fostering openness, strength and resilience*, COM(2021) 32 final, Brussels, 19.1.2021, pages 6 – 8 ([link](#))

<sup>10</sup> See footnote 10.

<sup>11</sup> Directive (EU) 2021/338 ([link](#))

<sup>12</sup> Proposal amending Directive 2014/65/EU as regards information requirements, product governance and position limits to help the recovery from the COVID-19 pandemic, COM (2020) 280 final, Brussels, 24.7.2020, pages 9 - 12 ([link](#))

<sup>13</sup> Regulation (EU) No 648/2012, consolidated ([link](#)) and EMIR implementing acts ([link](#))

<sup>14</sup> See the Study in Annex 1

<sup>15</sup> This clearing threshold is set for OTC commodity derivatives at a gross notional amount of EUR 3bn (“EMIR clearing threshold”).

The study compares the international treatment of OTC commodity derivative transactions relating to the clearing and margining obligation with a particular focus on non-financial market participants and their regulatory obligations. The aim is to identify the regulatory objectives of OTC-derivatives regulation; to outline the different legal approaches taken to achieve these and to determine the regulatory burden associated with these approaches. We considered the USA, Australia and Singapore as relevant competing jurisdictions because they have all satisfactorily implemented the goals of the (2009) G20 summit in Pittsburgh regarding OTC derivatives trading and are comparable markets regarding the size of the underlying market and the number and variety of international market participants.

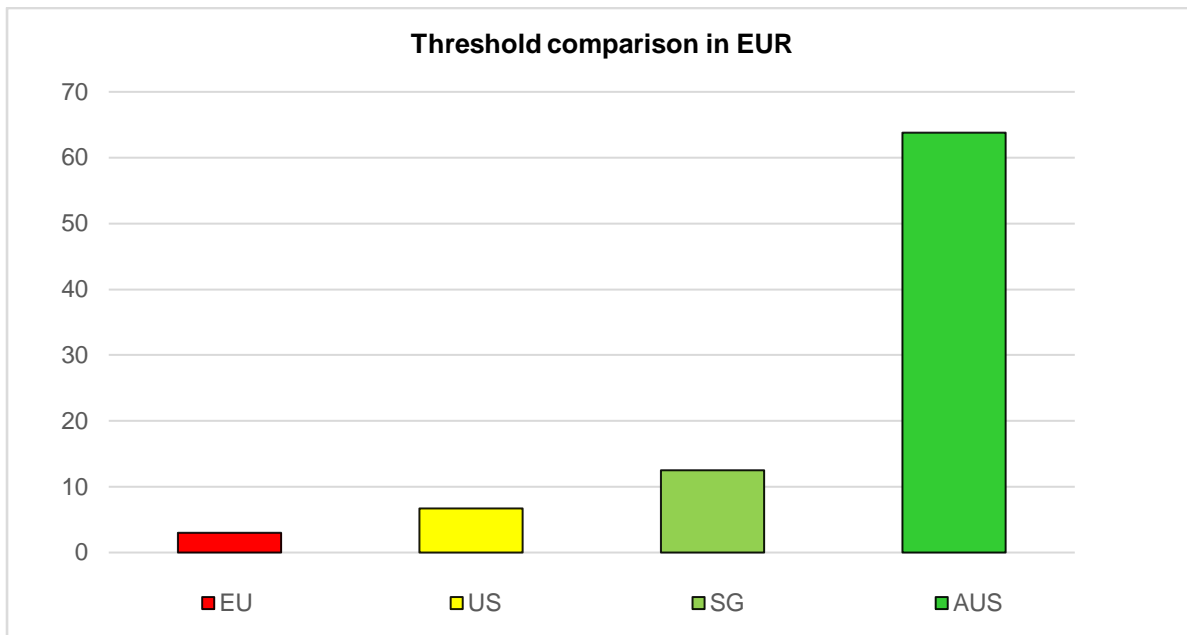
### EU EMIR rules have the most restrictive approach of all the jurisdictions considered

In general, we adhere to the main aims of EMIR to make derivatives markets more transparent, to mitigate credit risk and to reduce operational risks. However, as a result of the comparison between international standards of OTC derivatives markets regulation, we conclude that the approach used by the EU under EMIR is the most restrictive of all approaches.

The headline conclusion of the analysis is that the EU EMIR regime includes the lowest clearing threshold applicable to the largest set of entities, products and activities:

- Only the EU applies its regime to all trading activities around the globe without restriction, i.e. all world-wide energy and commodity derivatives activities count against the EMIR clearing threshold, even if no EU-product, EU-venue or EU-entity is involved;
- Only the EU includes any centrally cleared OTC derivatives as well as physically settled exchange traded derivatives into the threshold calculation;
- Several jurisdictions, including Australia and Singapore, limit the application of OTC-clearing regulations solely to financial institutions and, consequently, non-financial market participants are not limited to trade OTC markets as they are not subject to any clearing threshold test (hence, there is no hedging exemption for non-financial firms either); and
- Those jurisdictions which include non-financial market participants, including the U.S. and the EU, offer privileges for hedging transactions which are not considered for the clearing threshold. However, the definition of eligible commercial risks for hedging under EU EMIR is rather restrictive and the privilege correspondingly narrow.

The study also finds that the EU offers a commodity derivative clearing threshold of **3 bn EUR** per group against **8 bn USD** per group in the US, **20 bn SGD** per entity in Singapore and **100 bn AUD** per entity in Australia (see table below).



### Potential adverse consequences for the energy transition

As a result of this comparison, we conclude that the restrictive nature of the EU EMIR framework provides EU energy firms with limited headroom to offer suitable OTC hedging transactions to renewable energy producers in the EU and elsewhere in the world. This has direct adverse effects on the liquidity of OTC derivatives markets, the energy transition and the competitiveness of the EU.

In particular we note:

- The EU EMIR framework provides EU non-financial firms with only a very limited headroom to offer suitable OTC hedging products to renewable energy producers in the EU. When looking internationally it can be seen that the relatively low level of the EMIR clearing threshold of EUR 3bn for commodities creates a strong incentive for EU energy firms to reduce their OTC trading derivatives activities, including the provision of hedges to renewable energy producers.
- The reason is that for an energy firm providing hedges to renewable energy producers, these transactions will usually not be a hedge for themselves and count against the EMIR clearing threshold. This is because energy firms which enter into this type of hedging transactions do not usually hedge the commercial risks of their business but rather those of the renewable energy producers. The current restrictive hedging definition of Article 10(1) CDR 149/2013<sup>16</sup> and the applicable interpretation of ESMA QAs<sup>17</sup> do limit the ability of energy firms to categorise such transactions as reducing risk related to their own business.
- The consequence is that energy firms are incentivised to reduce these hedging activities to avoid the risk to breach the current EMIR clearing threshold. This is because non-financial firms above the EMIR clearing threshold, so-called NFCs+, must comply with prohibitive costly and burdensome regulatory obligations, including clearing and margining obligations.<sup>18</sup>
- In practice, this means that energy firms will offer a relatively limited number of hedging transactions to renewable energy producers. This is because the hedge transactions with renewable energy producers shall usually reduce a commercial risk of a long duration and great

<sup>16</sup> Commission Delegated Regulation (EU) No 149/2013 ([link](#))

<sup>17</sup> ESMA EMIR QA, OTC Question 10 ([link](#))

<sup>18</sup> See Annex 2 for a detailed description.

size.<sup>19</sup> Therefore, only a few hedging transactions can consume the entire EMIR clearing threshold of EUR 3bn for commodities.

- Additionally, this will limit renewable energy producers entry into so-called virtual power purchase agreements with industrial customers. These agreements are used as a means of investment financing as they secure the renewable energy producers a fixed margin for their power quantities (hedging) and are combined with the delivery of the Guarantees of Origin (GoOs) to the industrial customers for their de-carbonisation purposes. These OTC derivative transactions count against the EMIR clearing threshold insofar as the restrictive hedging definition of EMIR prevents the industrial customer from classifying them as a hedge.
- Therefore, it is important that energy market participants are encouraged to further develop the OTC energy and commodity derivatives markets so that the market liquidity and consequently the hedge opportunities for renewable energy producers are increased. This aim can be best achieved through an increase of the EMIR clearing threshold for commodities to a level comparable to the threshold level of the above-mentioned jurisdictions (see table above).
- The EU EMIR exposes EU energy firms to a substantial competitive disadvantage vis-à-vis firms from 3<sup>rd</sup> country jurisdictions because the latter are either not subject to the EU EMIR clearing rules or can make use of the more lenient OTC derivatives regime in their home jurisdictions. The global nature of the EU-approach leads to much higher notional values since any OTC-derivative transaction of any non-EU group company concluded anywhere in the world contributes to the EU group's clearing threshold consumption. For example, if a U.S. subsidiary of a European group enters into a financial swap with the aim to provide a hedge to an U.S. established Texas wind farm, the EU parent of this U.S. subsidiary must include this in its EMIR threshold calculations. Equally, an EU group is constrained by the EMIR clearing threshold to provide hedges to EU firms, while any 3<sup>rd</sup> country firm could compete without that limitation.
- These effects are compounded by the fact that intercompany transactions are not exempted from the EU EMIR clearing threshold, while in other jurisdictions, such as the U.S. or Australia, intra-group transactions do not count for the purpose of the clearing threshold calculations.
- Finally, we would like to emphasise that the low EMIR clearing threshold and comprehensive nature of the EU EMIR regime does not have the intended effect of pushing more commodity trading on venue. It simply limits the ability for energy firms to provide liquidity to OTC markets and therefore limits the hedging opportunities for renewable energy producers.

A substantial increase of the EMIR clearing threshold for commodities to a more systemic level comparable with thresholds in 3<sup>rd</sup> country jurisdictions is a relatively easy to implement measure to avoid these negative consequences and to ease the burden of implementation of non-financial firms under EMIR.

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Annex 1: Commodity derivative clearing under EMIR – A cross jurisdictional analysis

Annex 2: NFC+ obligations and implementation efforts

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<sup>19</sup> Example: An operator of an offshore wind farm sells its produced power at a floating price but wants to secure a minimum fix cash inflow via an OTC power swap where he receives fix and pays indexed price for an agreed amount of power. The transaction parameters are (a) 10-year tenor, (b) 250 MW capacity, (c) 40% load factor (runs 40% of all times with full capacity) and (d) 70 EUR/MWh agreed fix price. This single hedge transaction leads to a consumption of the EMIR clearing threshold by the hedging provider of 613,200,000 EURO ( (10 year x 8760 h/year x 40% x 250 MW) x 70 EUR/MWh = 8,760,000 MWh x 70 EUR/MWh).