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| 17 November 2021 |

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| Reply form for the Discussion Paper on the review of the clearing thresholds under EMIR |
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| Date: 17 November 2021 |

Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Discussion Paper on the review of the clearing thresholds published on the ESMA website.

*Instructions*

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

* use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
* do not remove the tags of type <ESMA\_QUESTION\_DP\_EMIR\_CTs> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
* if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

* if they respond to the question stated;
* indicate the specific question to which the comment relates;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

**Naming protocol**

In order to facilitate the handling of stakeholders’ responses please save your document using the following format:

ESMA\_DP\_EMIR\_CTs\_NAMEOFCOMPANY\_NAMEOFDOCUMENT.

e.g. if the respondent were ESMA, the name of the reply form would be:

ESMA\_ DP\_EMIR\_CTs\_ESMA\_REPLYFORM

***Deadline***

Responses must reach us by **19 January 2021.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

***Publication of responses***

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that 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 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](http://www.esma.europa.eu) under the headings ‘Legal notice’ and ‘Data protection’.

# General information about respondent

|  |  |
| --- | --- |
| Name of the company / organisation | ENGIE SA |
| Activity | Non-financial counterparty |
| Are you representing an association? |[ ]
| Country/Region | France |

# Introduction

Please make your introductory comments below, if any:

<ESMA\_COMMENT\_DP\_EMIR\_CTs>

TYPE YOUR TEXT HERE

ENGIE is of the opinion that ESMA’s review of the EMIR clearing thresholds offers an opportunity to facilitate the energy transition, enhance European competitiveness and improve market functioning, whilst safeguarding transparent and safe financial markets.

**We therefore urge ESMA to review and increase the EMIR clearing threshold for commodities (“EMIR CCT”) to a systemic relevant level, considering the higher level of clearing thresholds in 3rd country jurisdictions (e.g., the USD 8 Billion threshold under the U.S. Dodd-Frank-Act) and lower breadth of application across these jurisdictions (cf. our response to Question 6).** This proposal means that only relatively simple amendments to the Level 2 text of EMIR (Article 11 of Regulation (EU) No 149/2013) would be required.

This EMIR CCT increase would facilitate the energy transition and enhance European competitiveness 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 subject to the same G20 commitments to regulate derivatives markets, 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 Benchmark 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.

The above is substantiated through the attached independent Benchmark Study of 4 October 2021 (“Commodity derivative clearing under EMIR - A cross jurisdictional analysis –“) conducted by an international law firm.

<ESMA\_COMMENT\_DP\_EMIR\_CTs>

1. Please explain if you see a need for further clarification on how to identify OTC contracts for the purpose of the calculation of the positions to be compared to the clearing thresholds.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_1>

TYPE YOUR TEXT HERE

We are of the opinion that a substantial increase of the EMIR clearing threshold for commodities to an internationally comparable and more systemic relevant level (e.g., the USD 8 Billion threshold under the U.S. Dodd-Frank-Act), is necessary to facilitate the energy transition, enhance European competitiveness and improve market functioning, whilst safeguarding transparent and safe markets (cf. our response to Questions 6). For this purpose a change of the Level 2 text of EMIR would be required (Article 11 of Regulation (EU) No 149/2013) as any changes to ESMA’s QAs on EMIR implementation would not be sufficient to achieve these objectives.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_1>

1. Please explain if you see a need for further clarification to identify OTC contracts that can be considered as reducing risks directly relating to commercial activity or treasury financing activity. And please mention any additional aspects to be further considered with regards to the hedging exemption.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_2>

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Hedging transactions are excluded from the EMIR threshold calculations for commodities (“EMIR CCT”). What constitutes a trade that is “objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the NFC or of that group” is further defined in the Level 2 text of Article 10(1) of Commission Delegated Regulation (EU) No 149/2013 (“CDR 149/2013”). We note that the existing EMIR definition of hedging is very similar to the definition in 3rd country jurisdictions such as the U.S. and acknowledge that it rightly includes portfolio- and macro hedging and hence its definition is not narrower than in comparable 3rd country regimes. However, we note in this context that the substantially higher clearing threshold in those 3rd country jurisdictions (e.g., the USD 8 Billion threshold under the U.S. Dodd-Frank-Act), renders the limitations of the current hedging exemption less problematic. Therefore, we are requesting to keep at least the current Level 1 and 2 definitions of hedging in place and to keep this independent of any future review of the EMIR CCT.

**However, we believe that the understanding of the term of underlying commercial business (“*commercial activity*”) in Art. 10 (3) of EMIR REFIT, which can be hedged through OTC derivatives transactions, should be clarified by ESMA through its EMIR QAs under the current Level 2 text of Article 10(1) of CDR 129/2013 to cover the following commercial activities**:

* The term “commercial activity” is currently understood to cover only non-financial business (non-MiFID II activities), i.e., currently it does not cover transactions qualified as commodity derivatives under MiFID II. Therefore, hedging the commercial risk of a first (non-hedging) derivative transaction – which forms part of the main commercial business of an NFC – with another second risk-reducing derivative transaction is currently not recognised as hedging, although economically the latter transaction can reduce the market price risk of the former.
* **Hence, the understanding of the term “commercial activity” could be clarified to cover the hedging of risks stemming from entering into financial instruments (commodity derivatives), when these financial instruments belong to the core commercial activity of an NFC-, e.g., those NFC-s whose core commercial activity is to deal in financial instruments as specialised energy and commodity trading firms do.**
* We understand from the wording of the new ESMA EMIR QAs (OTC Question 10 (d), page 29, 31 – see [link](https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52_qa_on_emir_implementation.pdf)) that a core commercial activity of an NFC can consist of buying, selling or owning financial instruments.

This concerns the following cases:

* **Where the OTC derivatives are used as part of the main commercial activity:**

For example, if an energy trader or other energy firms enter into a virtual Power Purchase Agreement (“PPA”), e.g., in the form of a financially settled swap fix-for-floating, with a renewable energy producer. In this respect we would like to stress that energy firms are playing an increasingly important role in facilitating and enabling renewable energy projects, for example, wind farms and hydrogen plants. Due to various considerations including regulatory constraints this facilitation regularly takes the form of virtual offtake structures which renewable energy asset developers and producers require as a risk management tool (and without which these projects would not materialize).

Hence, these PPAs are used as a means of investment financing as it secures the renewable energy producer a fixed margin for its produced power quantities. The payments under such contracts depend not only on a price index, but also on the real physical production of a wind or solar farm by taking account the meter data of produced renewable energy (“pay as produced”). Therefore, these contracts share some characteristics of commercial power production and physical delivery activities.

These virtual offtake structures (such as virtual PPAs) qualify today as MiFID II financial instruments and therefore such activity is not deemed to constitute an eligible underlying commercial activity that could be hedged through OTC derivatives from the perspective of the energy trader. This narrow understanding of commercial activity is hence putting a real limitation to renewable energy business development.

The renewable energy industry would in our view greatly benefit from a clarification of the definition of underlying commercial activity to include financial instruments offered by NFCs as a risk management service to third parties for physical renewable energy project development.

* **Hedging of currency (FX) risks:**

Financial commodity derivatives are often concluded by energy trading firms to hedge potential price movements, e.g., in physical energy supply contracts or raw materials, which are required within the construction phase of renewable energy projects. Within internationally active company groups, these financial hedges may not necessarily be concluded in the same currency in which the company generally finances itself or otherwise generates cash flows. To reduce this currency risk, companies often enter into FX transactions. As these FX transactions (which are not means of payment under Article 10 CDR 2017/565) are concluded in relation to another financial instrument (the aforementioned financial commodity hedge), these products currently cannot be recognised as an EMIR hedge, although they clearly reduce the currency risk within the group. It would be helpful to clarify that these types of transactions qualify as eligible treasury financing activities in accordance with Art. 10 CDR 149/2013.

* **Mitigation of commodity price risks:**

An energy trading firm might enter into a financial commodity derivative with another NFC to hedge its commodity price risk stemming from another commodity derivatives transaction previously entered into in the course of its core activity of energy trading. If that latter derivative does not hedge a corresponding commercial risk of the energy trading firm, that latter derivative is of a non-hedging nature, but still forms part of the core commercial activity of the concerned energy trading firm. In such a case the energy trading firm typically hedges the commodity price risk from the original derivative by entering into a further offsetting derivative which from an economical perspective is an effective hedge and thus objectively measurable as reducing the risk from the original derivative and thus should be classified as a hedge under the EMIR Level 2 rules.

Furthermore, we would also support ESMA's suggestion in its June 2019 letter to the European Commission ([link](https://www.esma.europa.eu/sites/default/files/library/esma70-151-2392_letter_to_ec_-_emir_refit_-_hedging_exemption_in_the_calculation_of_the_clearing_thresholds.pdf)) that **financial counterparties should be able to take into account the hedging exemption available to non-financial counterparties when calculating the positions of the entities in the group to which the financial counterparty belongs**. At the moment, a financial counterparty is required to take into account the positions of all entities in its group, whether FCs or NFCs, whether these are hedging or non-hedging positions. However, the NFCs in that group would calculate their position based on the non-hedging positions of the NFCs in the group. This requires a group containing FCs and NFCs to carry out at least two different sets of calculations for the same group entities. We agree with ESMA that if it is appropriate to assess the positions of an NFC based only on non-hedging positions, it should also be appropriate for an FC in the same group to assess the positions of NFCs in its group on the same basis. However, the current ESMA EMIR QAs (OTC Question 3 (h), page 20, 23 – see [link](https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52_qa_on_emir_implementation.pdf)) states – based on a response from the EU Commission – that Article 4a(3) of EMIR does not provide for a hedging exemption for financial counterparties.

<ESMA\_QUESTION\_DP\_EMIR\_CTs\_2>

1. Please provide information and examples on how counterparties count fungible ETDs and OTC derivatives for the purpose of the calculation of the clearing thresholds?

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_3>

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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 hedge their commercial risks if they can enter into tailor-made hedging transactions on OTC markets, i.e., if there are energy firms which are willing and able to offer suitable OTC hedge transactions to them. However, the EMIR clearing threshold for commodities (“EMIR CCT”) discourages these energy firms from providing liquidity to OTC markets and offering effective risk management opportunities to renewable energy producers.

**In this context, we are of the opinion that there are usually no fungible financial instruments for these hedging purposes that are traded on regulated markets as well as off-venue.** This is for the following reasons:

* 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 specific risks, they must be able to enter into tailor-made, bilaterally negotiated OTC hedging transactions with energy market participants. These transactions are usually not available at exchanges.
* Thus, managing these risks relies on the presence of firms in the OTC markets 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. Such contracts cannot be found on regulated markets.
* In addition, even for more standardized risk profiles the contracts in the OTC trading 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).
* Also, market participants do not use exchange products because the setup of an exchange access and the ongoing exchange and clearing processes are too resource intensive and particularly, exchange trading requires the provision of substantial liquidity funds to fulfil the huge variation and initial margin calls from CCPs.
* Finally, industrial consumers 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 fixed-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. The reason is that for physical PPAs there are fewer potential counterparties and hence less liquidity as physical delivery requires the capability of both counterparties to handle physical deliveries.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_3>

1. Please provide data and arguments to illustrate the potential impact of the lack of an equivalence decision under Article 2a of EMIR and what could be done to alleviate your concerns (besides an equivalence decision)? Please specify the kind of transactions and activities that would be affected and the purpose of those, and whether there are alternatives.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_4>

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**Adverse impacts of the lack of an equivalence decision under Article 2a of EMIR**

**Introduction**

**We are of the opinion that an unconditional and unlimited recognition of LME and IFEU as equivalent by the EU is still the appropriate and targeted mitigant for this particular UK non-equivalence issue caused by Brexit. However, any future recognition of UK commodity exchanges will not remedy the problems triggered by the low EMIR CCT and the wider issues of the EMIR CCT as explained in our responses to this consultation (cf. our responses to Question 6).**

**Therefore, we are of the opinion that ESMA and the EU Commission shall by way of an EMIR quick fix proceeding substantially increase the EMIR CCT to an internationally comparable and more systemic relevant level (e.g., the USD 8 Billion threshold under the U.S. Dodd-Frank-Act; cf. our response to Question 6).**

The adverse impacts of the absence of an equivalence decision in respect of ICE Futures Europe (“IFEU”) and London Metal Exchange (“LME”) under Article 2a of EMIR are caused by the regulatory fact that trades executed on these platforms will constitute over-the-counter (OTC) trades for the purposes of EMIR:

* EU Non-financial firms (“EU NFCs”), with OTC derivatives in excess of pre-defined EMIR clearing thresholds, are classified as “NFC+s”.
* The clearing threshold for commodities under EMIR is defined at a relatively low level of a gross notional value of EUR 3bn (“EMIR CCT”). This threshold is assessed on a group-wide and world-wide basis, with hedging trades ignored.
* In practice, the non-equivalence under Art. 2a of EMIR and re-characterisation of derivatives traded on non-equivalent UK venues, i.e., ICE and LME, as OTC derivatives expose EU NFCs to the risk of exceeding the EMIR CCT.
* Consequently, the lack of an equivalence decision exposes EU NFCs to the risk of becoming NFC+s, which are subject to mandatory clearing and/or bilateral margining requirements as well as certain other more onerous elements of EMIR, although the transactions on IFEU and LME are centrally cleared and margined according to international standards.

**The consequence of this risk 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 CCT, due to lack of alternative similar venues for trading.** This situation places EU NFCs at a competitive disadvantage when compared to 3rd country firms and this is solely based on a regulatory necessity for EU firms to avoid breaching the EMIR CCT.

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.

**Manifold adverse impacts triggered by lack of an equivalence decision**

In the following sections we summarise the adverse impacts of the missing equivalence decision under Article 2a of EMIR under the currently low level of the EMIR CCT:

**1. Overview of stark choices for NFCs in the EU with adverse consequences for energy firms, industry and consumers**

The consequence is that EU NFCs face an immediate stark choice between

* **restricting their trading activities on UK exchanges** to avoid breaching the EMIR CT, due to lack of alternative similar venues for trading **(see nr. 2)**; or
* **not being able to provide sufficient liquidity to OTC derivatives markets** to enable efficient hedging of the real economy **(see nr. 3)**; or
* **meeting costly and burdensome NFC+-EMIR requirements** **(see nr. 4)**; or
* **facing competitive disadvantage vis-à-vis 3rd country firms and markets** **(see nr. 5)**.

There are **limited options to mitigate this adverse impact of the lack of an equivalence decision, in particular in case the migration of trading to alternative trading venues is not possible** (**see nr. 6**).

In the following paragraphs we highlight the main aspects:

**2. EU NFCs face the risk of exceeding the EMIR CT and hence have to restrict their trading activities**

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 CCT. 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 CCT builds up. Therefore, the impacted energy firms are forced to restrict their non-hedging trading activities on UK exchanges if they want to avoid breaching the EMIR CT.

This issue is compounded by the fact that commodity trading venues in numerous jurisdictions are not recognised by the EU Commission as equivalent, e.g., venues in United Arab Emirates, China, Russia, Turkey and Brazil in the near future.

**3. Insufficient liquidity for efficiently hedging commercial risks in OTC derivative markets**

In addition, non-hedging OTC derivatives transactions continue to contribute to the EMIR CCT as well. For EU NFCs seeking to hedge their commodity risks it is traditionally these OTC derivatives that represent the provision of important hedging solutions for industrial and commercial customers. For example, renewable energy producers can hedge their 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, for an energy firm which provides 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 interpretation of the hedging definition of Article 10(1) CDR 149/2013 and the applicable interpretation of ESMA QAs do limit the ability of energy firms to categorise such transactions as reducing risk related to their own business.

The missing equivalence decision means that the above-mentioned provision of liquidity to OTC markets is at risk as NFCs are already using the EMIR CCT headroom for their ICE and LME trading activities. Therefore, they cannot provide liquidity on OTC commodity derivatives markets anymore. Consequently, market participants such as industrial producers, in particular those with no access to exchanges, will be increasingly challenged to find a counterparty willing to provide them with OTC hedges.

**4. NFC+ implementation: costly and burdensome compliance requirements only affect EU NFCs**

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 (Articles 10 and 11 EMIR) following an EMIR CCT breach. In particular, the bilateral collateralisation requirements increase the costs of, and might even jeopardize, the realisation of green energy projects due to liquidity impacts.

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

1. **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). These collateralization obligations apply to all asset classes of non-centrally-cleared OTC derivatives and across the entire corporate group. Exemptions are only available for a very limited range of products such as physically settled foreign exchange forwards and swaps, the principal amount of currency swaps and – transitionally until 2024 – some equity derivatives. In addition, NFC+s are allowed to reduce the amount of IM to be exchanged by EUR 10mn for intragroup transactions or by EUR 50mn for transactions with counterparties outside the group. However, these exemptions require agreement with the respective counterparty and are subject to complex monitoring obligations on group level. In addition, since there are essentially no exemptions for certain types of counterparties (except for securitisation SPVs), the obligation to post VM and IM applies to all companies of an NFC+ group to the full extent, irrespective of the individual portfolio and volume of transactions. For example, this includes project finance SPVs, that usually enter into very few transactions to hedge their interest rate exposure and which – given the ring-fenced nature of such project finance SPVs – naturally do not possess the liquidity and operational resources to collateralise transactions. The consequential sum of VM and IM for NFC+s can amount to more than **€ 1-2bn** per firm (plus additional costs due to operational effort to comply with NFC+ requirements). This leads to trapped liquidity which EU NFCs cannot, for example, invest in green energy projects or other economically sustainable activities. This trapped liquidity is counterproductive for achieving the aims of the EU’s Green Deal.
2. **Further risk mitigation techniques** such as timely confirmation deadlines, higher frequency of trade reconciliations, trade compressions and reporting requirements. The implementation and ongoing cost of these measures are considerable.
3. The **implementation time frame** of these requirements is **at least 12 months** and entails significant changes to operational, risk, collateral and legal procedures, including the setting up of a third-party custodian for the exchange of IM collateral.

**5. 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 either avoid breaching the EMIR CT or to implement an NFC+ Status. The competitive disadvantages are manifold for the concerned firms, for example:

* In particular, EU27 energy firms lose unfettered access to the huge liquidity pools on UK commodity exchanges. NFCs established in 3rd jurisdictions do not encounter the above-mentioned stark choice, as other jurisdictions do not have such a formal equivalence requirement in place or do recognize EU exchanges as equivalent under their financial market rules. For example, UK market participants continue to have unrestricted access to EU commodity exchanges as the UK recognized EU commodity exchanges as equivalent and for UK energy firms the transactions on UK exchanges do not count against the UK EMIR clearing threshold for commodities.
* Furthermore, reducing trading activities means in practice a considerable loss of opportunities for the concerned firms and/or leads to the permanent closure of trading activities and hence job losses in the EU

**6.** **Limited options of migration of trading to alternative trading venues**

We assessed the possibility of migrating commodities trading from third countries, including the UK, into the EU, as well as from the UK to third countries. Overall, we believe that this is not possible in the current environment.

**In summary, EU NFCs depend on their access to IFEU and LME as there are no sufficiently liquid alternative markets for the commodities traded on these exchanges and alternatives are unlikely to develop.** The reason is that alternative markets would invariably lead to market fragmentation, while most of these commodities are traded globally by international players who are not affected at all by the current difficulty faced by EU NFCs and, hence, these global players are not interested in shifting liquidity. Even initiatives of the commodity exchanges to create new centres of liquidity have ended in failure. The market prefers that the benchmark commodity contracts are concentrated on one exchange to attract the most liquidity and to provide maximum transparency. Historically, for Brent Crude & Products and LME Base Metals this marketplace has been in London.

In the following table, we provide an overview of benchmark products traded on IFEU and LME, other venues and their respective liquidity:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Commodity** | **UK Venue** | **Del. Type** | **Other Venue** | **Liquidity** | **Situation and Implications** |
| Coal – Newcastle | ICE Futures Europe | Fin. | CME | None | No alternative, as NEWC is currently exclusively traded on IFEU.  |
| Emissions – EUA/CER | ICE Futures Europe | Phys. | EEX | Medium | ICE will transfer EUA contracts from IFEU to ICE Endex. For the 2021 EMIR CT calculations the reclassification of IFEU EUAs continues to pose a serious problem for EU NFCs. The alternative venue EEX does not have any screen liquidity.  |
| Freight – Wet Freight | ICE Futures Europe | Fin. | CME | Medium | IFEU has the majority of the market share. |
| LNG – JKM (Platts) | ICE Futures Europe | Fin. | CME EEX | Medium | ICE is the market leader (95%). CME has a minority share currently (5%). EEX (PEGAS) has launched JKM products in March 2019 but it is not taking off resulting in negligible liquidity. |
| Metals – Copper,Zinc, Lead, Aluminum | LME | Phys. | CME | Medium / None | For copper only, CME is an alternative venue with a medium liquidity. For other metals there is no alternative venue. |
| Natural Gas UK - NBP | ICE Futures Europe | Phys. | EEX CME | Low | Has always been led by IFEU and here again EEX offering did not take-off at all.[[1]](#footnote-2) Liquidity on CME is low. |
| Oil – Financials & Spreads | ICE Futures Europe | Fin. | CME | High | Not all Spreads are available. |
| Oil – Brent | ICE Futures Europe | Fin. | CME | High | Contracts difficult to replicate are Brent and Gasoil (led by IFEU) and WTI, RBOB and Heat (led by CME).Brent and WTI could be replicated by each alternative exchange as they are traded currently like this for arbitrage purposes. |
| Oil - Gasoil | ICE Futures Europe | Phys. | CME | Low | There is no reasonable alternative as gasoil is led by IFEU. |

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_4>

1. Please describe the scenarios when transactions do not qualify as hedging transactions.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_5>

TYPE YOUR TEXT HERE

We refer to our response to Q2 above.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_5>

1. Please describe your views on how the EMIR framework works (also compared to other regimes) for the purpose of the clearing thresholds and the requirements triggered by those? Please provide examples and supporting data.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_6>

**Introduction: Increase of EMIR CCT as quick-fix solution to** **support the energy transition and improve the EU’s competitiveness**

**A substantial increase of the EMIR clearing threshold for commodities (“EMIR CCT”) to a more systemic level comparable with thresholds in 3rd country jurisdictions (e.g., such as the USD 8 Billion threshold under the U.S. Dodd-Frank-Act; cf. Section 1a below) is urgently needed to facilitate the energy transition and enhance European competitiveness.**

Therefore, we propose to ESMA and EU Commission to increase the EMIR CCT by way of a quick-fix amendment to Article 11 of Regulation (EU) No 149/2013. This will facilitate the energy transition, enhance European competitiveness, ease the burden of implementation of EU NFCs and improve market functioning, whilst safeguarding transparent and safe markets.

It has to be acknowledged that sufficient headroom to offer OTC-transactions and to provide liquidity to third parties is required to enable overall economic growth and stability. This aspect is fully considered under the U.S.-DFA where the applicable USD 8 Billion clearing threshold is determined on the basis of how much liquidity is needed to allow commercial end users to manage their risks. This liquidity, however, would dry up if energy market participants such as corporate utilities have to develop their commercial strategy on the basis of not breaching a very low EMIR CCT. Exceeding this threshold is too burdensome and costly and therefore, limiting the trading activities, to the disadvantage of the market, is often the only option available. With exactly the same considerations, the U.S. CFTC found it appropriate to determine the threshold by the needs of commercial end users to still find a sufficient number of non-regulated counterparties which, if regulated, would cease such activities and consequently liquidity, i.e., offerings of OTC hedging transactions, would reduce accordingly.

This potential development represents a real and urgent threat: The relatively small number of non-financial counterparties above the EMIR CCT (“NFC+s”) does not signify that this threshold is set at a high level. It rather reflects the fact that staying below is the dominant corporate strategy. Therefore, the level at which the EMIR CCT is currently set has a very real and limiting impact on corporate activity. With that, and keeping the threshold at the current level, no additional liquidity from non-financial firms will be provided because the costs incurred by exceeding the threshold outweigh any additional income. Given the fact, that such liquidity is needed to foster economic investments, in particular regarding the energy transition, increasing the EMIR CCT is the only solution for the market.

The reason that, at this stage, we support not conducting a more fundamental review of the Level 1 EMIR text to address the broader issues of the EMIR CCT is that it would come too late. Such changes – taking account of the given review timeline under EMIR (ESMA report in 2023 and EU Commission report in 2024) – would not be in force and applicable before 2026 or 2027. We note that the EU Commission’s previous EMIR Refit proposal took 2 years before it entered into force and applied (the EU Commission’s proposal of 04 May 2017 was published in the OJ in its adopted form on 28 May 2019 and applied on 17 June 2019). This would be too late in light of the urgency to implement the EU’s Green Deal and to realise the energy transition by 2030 and that otherwise the competitive disadvantages to EU markets and firms will persist for a further 4-5 years.

**Structure of this response section**

In this context, we explain in the following sections:

* **Section 1**: the main results of an **independent legal benchmark study**, which shows that the EU EMIR regime includes the lowest clearing threshold applicable to the largest set of entities, products and activities. This has unintended material adverse consequences on the energy transition and the EU’s competitiveness.
* **Section 2**: the **broader issues of the EMIR framework and of the EMIR CCT calculations** which specifically NFCs face and which emphasise the low level of the EMIR CCT. In a nutshell, the current EMIR framework and underlying methodologies to calculate the EMIR CCT unduly inflate the gross notional values of OTC derivatives counting against the EMIR CCT

**1. Independent benchmark study of** **international standards of OTC derivatives markets regulation**

We would like to highlight that EFET has commissioned an independent assessment of international approaches to the regulation of OTC energy and commodity derivatives markets (“Benchmark Study”). This attached Benchmark Study of 4 October 2021 compared the EU EMIR rules with international standards for the clearing and margining obligations of non-financial firms (NFCs). In this context, EFET paid particular attention to the fact that under the EU EMIR rules non-financial firms’ whose annual transactions are above a defined EMIR clearing threshold (so-called “NFCs+”) become subject to mandatory central clearing and/or bilateral margining requirements.

The Benchmark 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 them 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 either the size of the underlying marketand/or the number and variety of international market participants.

**a) 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 Benchmark Study 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 EMIR’s clearing threshold, even if there is no EU-product, EU-venue or EU-entity involved;
* Only the EU includes any centrally cleared OTC derivatives as well as some 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 on 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.

Please note that the above-mentioned findings are explained in more depth in the attached Benchmark Study of 4 October 2021. To explain the above-mentioned findings in more detail, we have copied an overview of this study into the section below **“Benchmark Study: Table commodity trading and the clearing obligation (global)”.**

Here we want to highlight that this study also finds that the EU offers a commodity derivative clearing threshold of **3 bn EUR** per group (“EMIR CCT”) 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).

**Benchmark Study: Table commodity trading and the clearing obligation (global)**

|  | **EU** **(EMIR)**  | **US****(DFA)**  | **AUS****ASIC****(Derivative** **Transaction****Rules)**  | **SG****(Clearing** **of Derivatives** **Contracts Regula-****tions)** |
| --- | --- | --- | --- | --- |
| **I. Purpose and scope** | **Reducing of systemic risk by mandatory clearing.** **Determination of market participants relevant for the clearing mandate****(Pittsburgh commitments)** | **Reducing of systemic risk by mandatory clearing.** **Determination of market participants relevant for the clearing mandate****(Pittsburgh commitments)** | **Reducing of systemic risk by mandatory clearing.** **Determination of market participants relevant for the clearing mandate****(Pittsburgh commitments)** | **Reducing of systemic risk by mandatory clearing.** **Determination of market participants relevant for the clearing mandate****(Pittsburgh commitments)** |
| **1. Threshold Amount** | **3 bn EUR****- per group -** | **8 bn USD****- per group -** | **100 bn AUD****- per entity -** | **20 bn SGD****- per entity -** |
| **2. In-scope entities** | **All entities, including non-financial entities and end-users** | **“Dealers”: Swap Dealers and Major Swap Participants; no commercial end users** | **Only financial entities****(clearing entities)** | **Only banks** |
| **3. In-scope activities** | **Any trading activity** | **“dealing activities”** | **Trading in representing capacity and personal capacity** | **Any trading activity** |
| **a) third party dealing** | **Yes** | **Yes** | **Yes** | **Yes** |
| **b) own account dealing** | **Yes** | **Only if separate P&L center or resources specifically allocated to such business** | **Yes** | **Yes** |
| **4. In-scope products** | **“OTC-Derivatives”** | **“Swaps”** | **“OTC-Derivatives” for financial settlement, excluding venue traded instruments** | **“OTC-Derivatives”, excluding venue traded instruments** |
| **a) includes physically settled products** | **Yes** | **No, with limited practically irrelevant exemptions** | **No** | **Yes** |
| **b) includes physically settled ETD on third country venues** | **Yes, if venue not individually recognized as equivalent** | **No, excluded due to physical settlement and in most cases not considered Swaps** | **No, excluded due to physical settlement and not considered OTC** | **No, not considered OTC** |
| **c) includes financially settled ETD on third country venues** | **Yes, if venue not individually recognized as equivalent** | **Practically not, products usually not considered Swaps, inclusion would further depend on US-impact, indicated by involvement of a US person, guaranteed entity or significant risk subsidiary; general exclusion of certain foreign boards of trade** | **No, not considered OTC due to general recognition of major third country venues in the law** | **No, not considered OTC** |
| **5. Geo-graphical coverage** | **Global reach for all in-scope instruments and activities** | **All activities of US persons. Activities of affiliated non US-persons only if guaranteed entities or significant risk subsidiaries or with US persons or guaranteed entities** | **Only Australian incorporated entities, entities representing Australian schemes or transactions booked in Australian branches or entered into in Australia**  | **Only Singaporean entities and instruments “booked in Singapore”** |
| **a) third country business of affiliates in scope** | **Yes** | **No, if not itself a guaranteed entity or significant risk subsidiary or with US persons or guaranteed entity counterparties** | **No** | **No** |
| **6. Includes intra-group transactions** | **Yes** | **No** | **No** | **Yes** |
| **7. Privileged transactions not counting against threshold** | **Yes** | **Yes** | **No, concept not applied** | **No, concept not applied** |
| **a) Hedging** | **Yes, if objectively measurable as reducing risks relating to entity’s commercial activity** | **Yes, if hedging physical positions or ‘‘relevant facts and circumstances’’ test fulfilled** | **No, concept not applied** | **No, concept not applied** |
| **i) third party commercial positions eligible for hedging** | **No** | **Generally not but case-by-case analysis required** | **No, concept not applied** | **No, concept not applied** |
| **ii) financial positions eligible for hedging** | **In general yes, depending on underlying risk** | **In general yes, depending on underlying risk** | **No, concept not applied** | **No, concept not applied** |
| **b) netting effects recognized** | **Yes, limited** | **No** | **No** | **No** |
| **II. Threshold 1. amount and reference** | **3 bn EUR** **Commodity threshold** **- per group -** | **8 bn USD****Single threshold****- per group -** | **100 bn AUD****Single threshold****- per entity -** | **20 bn SGD****Single threshold** **- per entity -** |
| **2. Reference period for calculation** | **Every 12 months as aggregate month-end average position for the previous 12 months** | **12 months rolling average of deals concluded** | **Position crossing at two consecutive calculation dates (one calculation date per quarter)** | **Position at last day of each of the last 4 quarters** |

**b) 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 European competitiveness.**

In particular we note:

* The EU EMIR framework provides EU non-financial firms with 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 by itself and count against the EMIR clearing threshold. This is because energy firms which enter into these types of hedge transactions do not usually hedge the commercial risks of their business but rather those of the renewable energy producers. The current restrictive understanding of the hedging definition of Article 10(1) CDR 149/2013 and the applicable interpretation of ESMA QAs 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 of breaching the current EMIR clearing threshold. This is because non-financial firms above the EMIR clearing threshold, so-called NFC+s, must comply with prohibitive costly and burdensome regulatory obligations, including clearing and margining obligations (see our explanations under Section 2 a below).
* 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 usually reduce a commercial risk of a long duration and great size as the following example shows.
* It only takes a few hedging transactions to consume the entire EMIR clearing threshold of EUR 3bn for commodities. We illustrate this impact based on a wind farm park with a total installed capacity of 1000 MW. We describe 3 scenarios where 250 MW, 500 MW and 1000 MW are hedged under a single virtual PPA:
	+ 250 MW capacity hedged: An operator of an offshore wind farm sells its produced power at a floating price but wants to secure a minimum fixed cash inflow via an OTC power swap where the operator 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) ).
	+ Same example, but 500 MW hedged: This single hedge transaction leads to a consumption of the EMIR clearing threshold by the hedging provider of 1,226,400,000 EURO ( (10 year x 8760 h/year x 40% x 500 MW) x 70 EUR/MWh = 17,520,000 MWh x 70 EUR/MWh) ).
	+ Same example, but 1000 MW hedged: This single hedge transaction leads to a consumption of the EMIR clearing threshold by the hedging provider of 2,452,800,000 EURO ( (10 year x 8760 h/year x 40% x 1,000 MW) x 70 EUR/MWh = 35,040,000 MWh x 70 EUR/MWh) ).
* Additionally, this will limit renewable energy producers’ entry into so-called virtual power purchase agreements (virtual PPAs) 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.
* Lenders to renewable energy projects do as a rule require the producer to conclude a bankable long term PPA with an offtaker to guarantee secure cash flows as prerequisite for such lending. If such a PPA counts against the clearing threshold for the offtaker, it will either not be provided at all or at shorter tenure and at higher costs.
* In addition, the current extreme volatility of market prices for power, EUAs and natural gas fully underlines the need for such long-term supply arrangements, secured and collateralized against market developments as any marketing or procurement on a short-term spot price basis would entail unbearable commercial risk to any party to such contract.
* Therefore, it is important that energy market participants are encouraged to further develop the OTC energy and commodity derivatives markets so that market liquidity and consequently 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.

**2. Broader issues of the EMIR framework**

Again, we request a quick fix increase to the EMIR CCT to address the urgent need to mitigate the adverse impacts on the energy transition and competitiveness of the EU markets as a more fundamental review of the EMIR Level 1 Text won’t be in place before 2026/27 (see our explanations above in the section “Introduction”).

**Structure of this response section**

In this context, we would like to raise the following broader issues with regard to the EMIR framework for NFC+ and of the EMIR CCT calculations, which emphasise the problems triggered by the low EMIR CCT:

* **Section a)**:

At first, we explain under **a)** below the **broader issues for NFCs under the EMIR rules which are triggered by the implementation of and compliance with an NFC+ status**.

In this context, we differentiate between:

* + the important transformation (implementation) efforts to become a compliant NFC+ on one side (see a) (1) below); and
	+ the challenges for the normal business conduct and development of NFC+s on the other side (see a) (2) below).

The current EMIR framework exposes NFCs to the stark choice to either restrict or even stop their trading activities or to implement a very burdensome and costly NFC+ status; and

* **Section b):**

Secondly, we explain under **b)** below the **specific issues that NFC+s encounter when they calculate their exposure to the EMIR CCT**.

The current EMIR framework and underlying methodologies of calculating the EMIR CCT unduly inflate the gross notional values of OTC derivatives counting against the EMIR CCT and hence reduce the headroom for NFCs.

**a) Broader issues of the EMIR rules triggered by the NFC+ implementation and compliance:**

In this section we describe the broader issues for NFCs under the EMIR rules which are triggered by the implementation of and compliance with an NFC+ status. In this context, we differentiate between

* the **important transformation (implementation) efforts** to become a compliant NFC+ (see **point (1) below**); and
* the **challenges for the business conduct and development** of NFC+s (see **point (2) below**).

**(1) Transformation (implementation) efforts to become a compliant NFC+ firm**

**Briefly, the current EMIR framework exposes NFCs to the stark choice to either restrict or even stop their trading activities or to implement a very burdensome and costly NFC+ status. In addition, an NFC+ status causes important limitations on firms’ business conduct and development.**

The effort and costs to implement all of the EMIR requirements applicable to NFC+ firms represent for almost all firms an unsurmountable obstacle and hence force concerned firms to restrict or even to stop their trading activities. For the very few corporate firms who implemented or might implement in future an NFC+ status, this implementation effort causes very high costs and burdensome work across their entire world-wide corporate group. The reason is that to comply with NFC+ status requirements, firms have to implement all of the following requirements at the same time.

Implementation of these requirements is at least 12 months and entails significant changes to operational, risk, collateral and legal procedures, including the setting up of a third-party custodian for the exchange of IM collateral.

* **Clearing obligation (Article 4 EMIR):**

NFC+s are required to clear all trades in eligible OTC derivatives, on a category-by-category basis. Currently, mandatory clearing under EMIR only applies to interest rate swaps and credit default swaps. Interest rate swaps are widely used by energy firms to hedge their financial obligations which would become much more complex and costly if they had to comply with the clearing obligation. Although it does not yet apply to commodities EMIR provides that ESMA can issue a Regulatory Technical Standard (RTS) to extend the clearing obligation to further products at any time. In this respect, ESMA has already considered issuing clearing obligations for equity and some foreign exchange derivatives in the past, which would have had an impact on energy firms as well. Credit default swaps are most widely used by FCs, such as larger banks, but occasionally by NFCs for hedging purposes as well and, hence, mandatory clearing of credit default swaps can arise as a material issue in practice for NFC+s as well.

* **Risk mitigation requirements (Article 11 EMIR):**
* Daily mark-to-market (Article 11(2) EMIR): NFC+s must mark-to-market the value of outstanding contracts on a daily basis.
* Exchange of collateral (Article 11(3) EMIR): NFC+s must have in place risk management procedures that require the timely, accurate and appropriately segregated exchange of collateral for OTC derivative contracts that are entered into on or after the clearing threshold has been exceeded. This collateralization obligation applies to all asset classes of non-centrally-cleared OTC derivatives and across the entire corporate group. The consequential bilateral margining requirements are by far the most burdensome and costly element of the EMIR obligations for NFC+s. The sum of VM and IM can amount to more than **€ 1-2bn** per firm, if firms can’t use the applicable exemptions under EMIR. Those exemptions are only available for a very limited range of products such as physically settled foreign exchange forwards and swaps, the principle of currency swaps and – transitionally until 2024 – some equity derivatives. In addition, NFC+s are allowed to reduce the amount of IM to be exchanged by EUR 10mn for intragroup transactions or by EUR 50mn for transactions with counterparties outside the group. However, these exemptions require agreement with the respective counterparty and are subject to complex monitoring obligations on the group level. In addition, since there are essentially no exemptions for certain types of counterparties (except for securitisation SPVs), the obligation to post VM and IM applies to all companies of an NFC+ group to full extend, irrespectively of the individual portfolio and volume of transactions. For example, this includes project finance SPVs, that usually enter into very few transactions to hedge their interest rate exposure and which naturally do not possess the liquidity and operational resources to collateralise transactions. This leads to trapped liquidity which EU NFCs cannot invest for example in green energy projects or other economically sustainable activities which in turn is counterproductive for achieving the aims of the EU’s Green Deal.
* **Timely confirmation (Article 12, Commission Delegated Regulation (EU) No 149/2013):**

Although all counterparties are required to provide timely confirmations, the time limit is shorter for NFC+s than NFC-s. NFC+s are required to provide confirmations by the end of the business day following the date of execution of the derivative contract. Conversely, NFC-s are only required to provide confirmations by the end of the second business day following the date of execution of the derivative contract.

* **Portfolio reconciliation (Article 13, Commission Delegated Regulation (EU) No 149/2013):**

Although all counterparties are required to perform portfolio reconciliation, NFC+s are required to do so more regularly than NFC-s. NFC+s are required to perform portfolio reconciliation: (i) each business day where the counterparties have 500 or more OTC derivative contracts outstanding with each other, (ii) once per week when the counterparties have between 51 and 499 OTC derivative contracts outstanding with each other at any time during the week, and (iii) once per quarter when the counterparties have 50 or less OTC derivative contracts outstanding with each other at any time during the quarter. Conversely, NFC-s are only required to perform portfolio reconciliation: (i) once per quarter when the counterparties have more than 100 OTC derivative contracts outstanding with each other at any time during the quarter, and (ii) once per year when the counterparties have 100 or less OTC derivative contracts outstanding with each other.

* **MIFIR Trading obligation (Article 28 MiFIR)**:

Since interest rate swaps are widely used by many corporates, NFC+ would – if they had to comply with the clearing obligation – also be affected by the trading obligation in accordance with Art. 28 MIFIR. The trading obligation as designed by MIFIR consists of the requirement placed on FC and NFC+s to conclude relevant transactions only on regulated markets, MTFs, OTFs or third country trading venues (subject to the European Commission decision on equivalence and reciprocity). Obviously, this would have an impact on liquidity and pricing (no OTC markets/counterparties), as NFC+s would no longer able to trade OTC.

**(2) Broader issues of NFC+ status triggering costs and complex processes for firms’ business conduct and development**

The NFC+ status triggers complex internal evaluation, approval and monitoring proceedings to ensure EMIR compliance with regard to the development of new renewable energy projects in the EU and globally. **More importantly, it also has an adverse impact on the firms’ competitiveness as it makes the sustainable growth through investments into renewable energy projects more complex and costly**.

* **NFC+ will make project financing more expensive and complex overall:**

An NFC+ status for a corporate group, which develops renewable energy projects in the EU and/or globally, introduces additional obstacles, complexity and costs on project finance transactions involving special purpose vehicles (“SPVs”). The reason is that – regardless of the ring-fenced nature of these SPVs – all entities which are part of an NFC+ group would be subject to all relevant EMIR rules, in particular the EMIR margining rules, as EMIR has a group-wide reach.

Non-recourse project financing is commonly used to realize large renewable energy projects, especially if other equity-partners are involved. In these structures a ring-fenced SPV raises project finance debt on a non-recourse basis, i.e., the debt repayment relies solely on the project’s cashflows. It is market standard that these project loans are structured on a floating interest rate basis and a long-term Interest Rate (“IR”)-Swap is executed to manage the IR-risks and provide cashflow certainty on all financing cashflows over the tenor of the debt. In addition, certain Foreign Exchange (FX)- or commodity hedges might be executed to stabilize project cashflows. This type of hedging is obligatory to achieve bankability of the projects.

For these types of SPVs (with cashflow based lending) the EMIR margining rules stand in stark contrast to the required cashflow certainty which is needed for bankability, as margining of the above-mentioned transactions introduces or reintroduces cashflow volatility. However, the key principle of a non-recourse project financing structure is to minimize cashflow volatility.

We are not aware of any non-recourse project financing in the energy sector which has been realized based on collateralization for finance derivatives. The EMIR margining rules will make a standard project financing impossible. To accommodate the EMIR margining rules in such financing will only be possible via significantly increased complexity in an off-market structure, which will lead to (a) increased financing costs, (b) reduced financing capacity for the projects (because of reduced lender appetite and debt capacity being consumed for working capital facilities) and (c) a potential need for additional and continuous shareholder financing (contradicting the non-recourse principle).

This makes an NFC+ a less attractive partner for investors as investors want to avoid these NFC+ obligations and impacts and, hence, they might not invest in the concerned asset. This makes EU NFC+s less competitive and reduces the scope of potential partners.

In conclusion this limits the funding capacity and partnering options for an NFC+, hence putting economic viability and the ability to finance of renewable energy projects at risk.

* **Hedging of renewable energy production through virtual PPAs becomes more expensive and reduces hedging opportunities:**

An operator of a renewable energy production site, e.g., of a larger wind park, enters into a so-called virtual Power Purchase Agreement (“PPA”), for example, in the form of a financially settled swap fix-for-floating, to financially hedge its commercial market price risks. If an NFC+ firm enters into a virtual PPA with another NFC+ or FC, this hedging transaction would typically be subject to the bilateral collateralisation obligation under EMIR. Consequently, this substantially increases the cost of hedging for the NFC+ firm and makes a renewable energy project less economically viable. Therefore, NFC+s face the stark choice to avoid that collateralisation by not entering into virtual PPAs with other larger corporates with NFC+ status and/or financial counterparties. Hence, this reduces the hedging opportunities as it reduces the number of potential counterparties available for hedging transactions.

* **Liquidity scarcity as a result of NFC+ status:**

A twofold liquidity impact leads to restrictions on operational and growth activities:

1. The liquidity buffers NFC+s have to provide for the risk mitigation measures (bilateral collateralization) which are substantially increased as a result of additional margin (in particular Initial Margins) requirements.

2. The net debt influence of Initial Margins might be limited only when NFC+s are able to apply a strict Initial Margin governance. For the purpose of staying below the defined threshold for posting Initial Margins, an operating model has to be established whereby transactions are (artificially and not based on business-led considerations) allocated to as wide a pool of counterparties as is possible. However, it is likely that in the normal course of business the defined Initial Margin limits will be exceeded. When the defined Initial Margin thresholds are exceeded, the not yet posted Initial Margins will have a substantial net debt influence and this with the potential to adversely impact rating metrics of an NFC+ firm.

Overall, liquidity scarcity for a given set of commercial activities increases as a result of NFC+ status, potentially hampering growth.

* **Merger & Acquisitions (M&A) become more complex:**

NFC+ status will make M&A transactions substantially more complex for NFC+ firms overall. When an NFC+ firm merges with or acquires another NFC- firm, the NFC+ firm must make sure that also the newly integrated NFC- firm complies with the above-mentioned NFC+ obligations at the point of time of integration into its corporate group. This triggers the heightened risk of not fulfilling EMIR obligations on time, including notification requirements. As intra-group transaction exemptions from margining obligations cannot be obtained quickly, this forces the NFC+ to not hedge the commercial risks through intra-group derivative transactions to avoid the margining obligation under EMIR. Depending on the nature and size of the M&A transaction, this causes substantial implementation challenges for both sides of the transactions. For example, the NFC+ firm usually can only start the related implementation work once it has full control over the NFC-, although it would have to ensure compliance upon integration of the M&A target. In addition, this makes NFC+s less attractive as a partner for an M&A transaction as the other M&A counterparty usually can’t or has no commercial interest in performing that compliance work. These above-mentioned complications will be the usual challenge as almost all potential M&A targets are NFC-s. Overall, these issues cause disadvantages to firms which are NFC+s, especially in relation to 3rd country firms.

**b) Broader issues of the EMIR CCT calculations:**

In this section we explain the specific issues NFC+ encounter when they calculate the use of the EMIR CCT under the current EMIR framework. In general [...] notes that the current EMIR framework for this calculation overemphasises the low EMIR CCT. **The current EMIR framework and underlying methodologies to calculate the EMIR CCT unduly inflate the gross notional values of OTC derivatives counting against the EMIR CCT.**

* **Wide global scope of EMIR CCT calculations under Level 1 of EMIR:**

The extensive global reach of the EMIR CCT calculations for all in-scope instruments and activities – when compared to the scope of the 3rd country regime (see nr. 5 of benchmark table above) – puts EU NFCs at a substantial competitive disadvantage vis-à-vis their international competitors. The EU EMIR exposes EU energy firms to a substantial competitive disadvantage vis-à-vis firms from 3rd 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. This is because under EMIR all world-wide energy and commodity derivatives activities count against the EMIR CCT, even if no EU-product, EU-venue or EU-entity is involved. This 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 3rd country firm could compete without that limitation. ESMA’s EMIR QA, OTC Question 3 (d) (3) ) confirms this understanding.

As a result, not only is the €3bn EMIR CCT the lowest in international context, but it is also meant to cover all global entities of a group whereas the USD 8 Billion threshold under the U.S.-DFA, apart from being higher and only applying to financially settled products, requires a US-market-nexus of the activity (cf. nr. 5 of Benchmark Study Table in Section 1 above). Absent such, it is not considered for group aggregation.

On top, approaches taken in Australia and Singapore, allocate a substantially higher threshold (100 bn AUD in AUS) on entity level (not group level!) solely available for transactions booked in Australia.

So, a single Australian entity can enter into a derivatives transaction summing up to 100 bn AUD in Australia alone whereas a European EMIR entity has to share a threshold of 3bn € not only with its entire fellow group EU companies but has to cover any global activity up to this amount. It is entirely obvious that the headroom for the European entity is nothing but a small fraction of that which is available to its competitor.

* **Low, fixed EMIR CCT quickly consumed when energy and commodity prices rise:**

The EMIR CCT was defined in 2012 at a low fixed level of a gross notional value of 3bn (see Article 11 (e) CDR 149/2013). When compared to the prices in 2012, in 2021 the prices for gas, power and EUAs have increased considerably. This means that the gross notional value of open positions in OTC derivatives contracts relating to these commodities have substantially increased and, consequently, NFCs` positions in these quickly consume the fixed EMIR CCT. Hence, the headroom available in 2021 for NFCs to enter into new OTC derivative transactions is dramatically further reduced when compared to the date of setting the EMIR CCT in 2012. Eventually, this could even mean that NFCs are forced to reduce their trading activities and/or close positions if the gross notional value of their existing open positions would exceed the EMIR CCT only because of these price increases. Therefore, the current low EMIR CCT level does not provide enough margin to NFCs to mitigate the current and any future price volatilities.

We further explain this development in the following paragraphs and show graphs displaying the price developments for gas, power and EUAs:

**Impact of EU ETS price developments:**

The following graph shows the monthly average price for the contract “ICE EUA Future Dec-21” from 2017 until December 2021. When compared to the monthly average price of the December contract in 2012 of 7.46€/t, it becomes clear that the contribution of EUA transactions in 2021 to the consumption of the EMIR CCT increased multiple times (December 2021 at least a factor of 8).

Graph 1: EUA ICE Future: Dec-21 monthly average

Source: Bloomberg

**Impact of power price developments:**

The graph below shows a similar picture for the power price developments based on a widely used benchmark contract. This graph shows the monthly average price for the contract “EEX Future Power Base Cal-22” from January until December 2021. When compared to the monthly average price of €45,50/MWh in December 2012 for the Cal-13 contract, it becomes clear that the contribution of power OTC transactions to the consumption of the EMIR CCT increased multiple times (December 2022 at least by a factor of 4). However, the End-of-Day price of 22 Dec 2021 is closed at €325,16/MWh (hence, a multiplication factor of 7).

***Graph 2: EEX Future Power Base Cal-22 monthly average***



Source: EEX

**Impact of gas price developments:**

The graph below shows a similar picture for the gas price developments based on a widely used benchmark contract. This graph shows the monthly average price for the contract “Gas TTF Forward Cal-22” from January until December 2021. When compared to the monthly average price of €27/MWh in December 2012 for the Cal-13 contract, it becomes clear that the contribution of gas OTC transactions to the consumption of the EMIR CCT increased multiple times (December 2022 at least by a factor of 3) However, the End-of-Day price 22 Dec 2021 is closed at €139,64/MWh (hence, a multiplication factor of 5).

***Graph 3: Gas TTF Forward Cal-22 monthly average***



Source: Heren

* **Increased price volatility leads to high margin calls for cleared transactions resulting in difficult choices**

In the context of the above-mentioned price increases for power, gas and EUAs market participants face increased margin calls for cleared transactions and consequently face liquidity challenges and, hence, tough choices, which are emphasized by the low level of the EMIR CCT.

Energy firms active in the EU markets have turned to the EU’s Regulated Markets to hedge their natural long and short asset positions, for example, their power production. Depending on their individual strategies and risks, these firms currently hold and manage considerable exchange traded derivative positions in one or more commodities on EEX or/and ICE Endex.

As a result of the recent spike in volatility of commodity prices, energy firms have been subject to an unprecedented increase and stress in liquidity demands for covering both their initial and (if applicable) additional margin obligations for cleared derivatives on various CCPs. These massive cash requirements which were hardly predictable and not easily manageable given the tight timelines - set in central clearing related legal frameworks – have forced industry firms to weigh some tough choices:

- Enter into a stop loss strategy and close affected positions on exchanges, with even further negative impacts on market liquidity and market volatility.

- Move positions to uncleared OTC derivatives markets, insofar as there are sufficient eligible counterparties that can shoulder the increase in their own EMIR CCT calculation

- Or where none of the above choices seem sustainable, exit the markets – which in the case of positions entered into for hedging purposes is not feasible as it will leave the firm exposed to very volatile markets.

* **No ring-fencing of bilateral margining requirements under Level 1 of EMIR:**

The main impact of the NFC+ status is triggered by the bilateral margining obligation under Article 11 (3) of EMIR, in particular by the initial margining requirements. The bilateral margining requirements are by far the most burdensome and costly element of the EMIR obligations for NFC+s. Contrary to the ring-fencing of the clearing obligation under Article 10 (1) (c) of EMIR, the bilateral collateralizationof non-centrally-cleared OTC derivatives is not ring-fenced as it applies to all OTC derivatives asset classes across the entire corporate group. For example, if an affiliated commodity trading firm breaches exclusively the EMIR CCT, the collateralisation requirements are not limited to uncleared OTC commodity derivatives, but are applicable to all asset classes of uncleared OTC derivatives in the entire corporate group, including, for example FX and interest rate derivatives. It is – inter alia – this wide scope that creates the major challenges for NFCs as explained in this response. We consider that it would be more proportionate and appropriate to provide for relief from other obligations under EMIR where an NFC is not subject to the clearing obligation. This means that an NFC would only be an NFC+ for any of the obligations under EMIR where it has exceeded the clearing threshold in relation to a particular asset class.

* **Need for equivalence decisions under Level 1 of EMIR for trading venues in 3rd countries:**

The need for an equivalence decision under Article 2a in conjunction with Article 2 (7) of EMIR considerably extends the population of global trading activities covered by the EMIR CCT calculation. In absence of such an equivalence decision, the contracts concluded on the concerned 3rd country venues are considered OTC and therefore counts towards the EMIR CCT, although they are usually centrally cleared. In practice, this materially increases the in-scope instruments as EU NFCs use trading venues in many 3rd countries, such as in the UK (IFEU and LME), United Arab Emirates, China, Russia, Turkey and Brazil in the near future.

Even if the Commission does start to make equivalence decisions under Article 2a, it is unlikely that they will cover all relevant jurisdictions or all relevant (future) commodity trading venues, so this situation will continue as long as the definition of "OTC derivative" is linked to an equivalence decision.

Other jurisdictions – cf. jurisdictions in nr. 4 b and c of table of Benchmark Study in Section 1 above and Switzerland (cf. page 21 of attached Benchmark Study) – do not include derivatives traded on 3rd country venues in their threshold calculations.

In this context we consider that it is neither proportionate nor appropriate to have an equivalence regime purely for the purpose of establishing whether a derivative contract should be considered OTC or not for the purpose of the EMIR CCT calculations. We are concerned that the current lack of equivalence decisions is leading to unintended consequences for EU firms

* **EMIR CCT calculation methods embedded in Level 1 and 2 of EMIR:**

In this sub-section we deal with some specific unhelpful technical aspects of the EMIR CCT calculation methods which reduce the usefulness of the EMIR CCT substantially. **The current methodologies unduly inflate the gross notional values of OTC derivatives counting against the EMIR CCT.**

**Restrictive netting under ESMA’s EMIR QA:**

Currently, for the purpose of the EMIR CTT calculation a very narrow understanding of netting is applicable (see ESMA QA (OTC Question 3 (f) ): Netting per contracts and counterparty should be understood as fully or partially offsetting contracts having exactly the same characteristics (type, underlying, maturity, etc.) with the only exception being the direction of the trade and notional amount (in case of partial offset) concluded with the same counterparty.

Other regulations applicable to energy commodity trading firms display a substantial wider understanding of netting, in particular for the ancillary activity tests under the CDR 2017/592.

**EMIR CCT calculation includes centrally cleared derivatives:**

EMIR CCT calculation includes OTC derivatives even if they are centrally cleared on EU CCPs or recognised 3rd country CCPs and hence in cases where the counterparty credit risk is fully mitigated.

The Level 1 text of EMIR (Articles 2 (7), 2a (1), 10 (1) provides that derivative contracts, which are not traded on EU regulated markets or on equivalent 3rd country exchange, are OTC Derivatives which count against the EMIR CCT. Bilaterally concluded OTC Derivatives, such as block trades, which are subsequently registered and executed at EU or equivalent 3rd country exchanges and then centrally cleared are therefore not OTC Derivatives for the purpose of the EMIR CCT calculation (ESMA EMIR QA, OTC Question 1 (d) ). However, OTC Derivatives which do not meet the latter conditions (i.e., they are not executed on an EU regulated market or equivalent 3rd country exchange and are not governed by the rules of an exchange at the point of execution) should be considered OTC Derivatives, even if they are centrally cleared at an EU CCP or recognised 3rd country CCP. This is the case for example for transactions entered into at the non-equivalent IFEU and LME which are subsequently centrally cleared at the recognised CCP of these exchanges. Also OTC Derivatives centrally cleared on a voluntary basis on such a CCP remain OTC derivatives for the purpose of the EMIR CCT calculations (ESMA EMIR QA, OTC Question 3 (d) (2) ).

**EMIR CCT calculation includes intragroup transactions:**

The EMIR CCT calculation under the Level 1 text of EMIR (Article 10 (3) ) includes intragroup transactions and this inflates the gross notional values of OTC derivatives counting against the EMIR CCT.

ESMA provides that if two NFCs belonging to the same group enter into an intragroup transaction with each other, which does not fall within the hedging definition, both sides of the transaction should be counted (ESMA EMIR QA, OTC Question 3 (d) (1)). The total contribution to the group-level threshold calculation would therefore be twice the notional amount of the contract.

This effect is compounded for non-financial groups, which typically use one trading entity as access to the markets that is specialised in dealing in commodity derivatives (the “trading entity”) with entities outside the group. If this trading entity enters into external derivative contracts which mirrors one or more non-hedging intragroup derivative contracts, then the EMIR CCT calculation would therefore amount to 3 times the notional amounts of these contracts (ESMA EMIR QA, OTC Question 3 (e)).

Therefore, the effects of the low EMIR CCT are compounded by the fact that intercompany transactions are not exempted from the EU EMIR CCT, 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 (see nr. 6 of Table Benchmark Study above).

**EMIR CCT calculations based on outstanding notional exposure under Level 1 text of EMIR:**

The calculation of the EMIR CCT under Article 10 (3) of EMIR is based on an outstanding notional exposure, i.e., shall be calculated by averaging the aggregated month-end outstanding notional values for the previous 12 months resulting from all relevant OTC derivatives contracts (ESMA EMIR QA, OTC Question 3 (a)). For example, the remaining outstanding notional exposure of a 10 year OTC swap counts during its entire duration against the EMIR CCT calculation.

Unlike under EMIR, under the U.S. DFA only swaps that have been entered into in the previous 12 months count against the threshold. Therefore, swaps entered into for a period of more than a year will drop out on a rolling basis. Any double or multiple counting of existing swaps and the respective open positions – as under EMIR – is avoided (see page 36 of attached Benchmark Study). In fact, the USD 8 Billion threshold under the Dodd-Frank Act measures the dealing activity of a person rather than the size of actual open positions

* **Definition of Hedging:**

Please see our response to Question 2 above.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_6>

1. Considering the current coverage provided by the clearing thresholds in relation to credit derivatives and the different type of counterparties (FCs and NFCs); is there any aspect or issue you consider ESMA should look into or pay attention to? Please, in your answer, provide as granular details and any relevant data to illustrate your response.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_7>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_7>

1. Considering the current coverage provided by the clearing thresholds in relation to interest rate derivatives and the different type of counterparties (FCs and NFCs); is there any aspect or issue you consider ESMA should look into or pay attention to? Please, in your answer, provide as granular details and any relevant data to illustrate your response.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_8>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_8>

1. Considering the current coverage provided by the clearing thresholds in relation to commodity derivatives and the different type of counterparties (FCs and NFCs); is there any aspect or issue you consider ESMA should look into or pay attention to? Please, in your answer, provide as granular details and any relevant data to illustrate your response.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_9>

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**We believe that ESMA should not focus on the EU perspective when performing the data analysis, but instead take a global approach for the following reasons:**

* The EMIR Commodity Clearing Threshold (“EMIR CCT”) calculation has a global scope. This is because under EMIR all world-wide energy and commodity derivatives activities count against the EMIR CCT, even if no EU-product, EU-venue or EU-entity is involved.
* Energy and commodity markets are global markets. Limiting the analysis to EU27 energy and commodity markets, underestimates the size of these markets which are actually global in nature and therefore overestimates the relative importance of EU27 NFCs in these global markets.
* A focus that is too narrow ultimately overestimates the systemic relevance of commodity trading by EU NFCs (see also our response to Q 12 where we argue that NFCs are not systemic relevant) and leads to too strict (low) clearing thresholds.

It is noted that ESMA might not have access to the same data with regard to trades conducted outside the EEA. However, a possible work-around could be a comparison of the EU trading data with derivative trading statistics from other jurisdictions (e.g. the US), to gauge the relative size of respective geographic market segments and thereby the size of the overall global market.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_9>

1. Considering the current coverage provided by the clearing thresholds in relation to equity derivatives and the different type of counterparties (FCs and NFCs); is there any aspect or issue you consider ESMA should look into or pay attention to? Please, in your answer, provide as granular details and any relevant data to illustrate your response.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_10>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_10>

1. Considering the current coverage provided by the clearing thresholds in relation to currency derivatives and the different type of counterparties (FCs and NFCs); is there any aspect or issue you consider ESMA should look into or pay attention to? Please, in your answer, provide as granular details and any relevant data to illustrate your response.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_11>

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<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_11>

1. Beyond the different treatments between FCs and NFCs in the calculation, are there differences between the different types of counterparties that might justify a different calibration of the actual clearing thresholds? In addition, please consider if a different calibration of the current clearing thresholds by type of counterparty should apply in the same manner to all asset classes. Please provide any supporting data that might help illustrate your response.

<ESMA\_QUESTION\_ DP\_EMIR\_CTs\_12>

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**We believe – in line with advice by the Committee of European Banking Supervisors (“CEBS”), academic literature and current market data – that the current (by global standards, quite low) EMIR commodity clearing threshold of €3 billion can be increased to a substantially higher level without jeopardising the stability of the wider financial markets:**

* The size of the commodity derivatives markets is very small compared to other derivatives markets – Commodity derivatives account for only 1% of the outstanding notional value in 2020 (see ESMA Annual Statistics, Figure ASRD.4), while almost 80% come from interest rate derivatives. The stability of the financial sector (a key objective of EMIR) is therefore mainly dependent on asset classes other than commodities.
* NFCs account for the largest shares of counterparties in commodity derivatives – NFC accounted for 39% of the total notional amount in commodity derivatives in 2020 (see ESMA Annual Statistics, Figure ASRD.19). The level of the commodity clearing threshold therefore mainly affects the non-financial sector.
* NFCs active on the energy and commodity markets are not of systemic importance for the wider traditional financial markets. A failure of a non-financial commodity trading firm would not trigger a “broader contagion” of the financial sector, for example, triggering the failure of a systemically important financial institution. This view is supported by numerous independent analyses. For example, the Advice of the Committee of European Banking Supervisors (“CEBS”) of 10th October 2007 to the EU Commission (“CEBS-Advice”; page 2, ref. 12) clearly stated that *“… systemic risk concerns … appear significantly smaller relative to the systemic risks posed by banks and ISD financial investment firms. In the commodities case studies examined in this report, systemic concerns were limited and contained*.” This analysis is still valid today because the characteristics and nature of commercial activities generally undertaken by commodity trading firms have not changed fundamentally. Further independent, more recent analysis confirms that commodity trading firms are unlikely to create systemic risk ([link](https://www.trafigura.com/media/1207/2015_trafigura_not_too_big_to_fail_en.pdf)). ESMA seems to share this view in its consultation paper (see para. 157: *“[…] the absolute number of NFCs trading with commodity derivatives […] is lower than for other asset classes, which suggest NFCs are less significant from a systemic risk perspective.*”).
* These arguments are supported by empirical evidence provided by Kerste et al. ([link](http://www.sciencedirect.com/science/article/abs/pii/S0301421514006831)), which shows that the high use of commodity derivatives in the energy sector does not imply high contagion risk from the energy sector towards the banking sector. Indeed, the correlation between defaults in the energy sector and defaults in the banking sector is comparable to that between the banking sector and the food and construction sectors.

<ESMA\_QUESTION\_DP\_EMIR\_CTs\_12>

1. Looking at the simulations presented in the paper and at the impact they would have, do you have any views on the sensitivities of the thresholds?

<ESMA\_QUESTION\_DP\_EMIR\_CTs\_13>

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ESMA’s consultation paper (see Section 10) presents simulation results for variation of the current clearing thresholds (decrease by €0.5 billion and increase by €0.5 and €1.0 billion). ESMA intends to analyse the impact of a potential change in the clearing threshold on share of FCs and NFCs which are captured by the threshold (p. 4).

We understand that ESMA conducts a *ceteris-paribus* calculation where it determines the shares of counterparties (notional value) below and above different levels of clearing thresholds based on the following observed trading data which is kept constant:

* Observed trading data for the year 2020, i.e. when FCs and NCFs were subject to the current clearing thresholds (e.g. €3 billion for commodities).
* Not capturing the non-equivalence of UK exchanges (effective 1 January 2021);
* Not capturing the recent price increase for commodities (in particular in the second half of 2021, see our response to Q 6).
* The data also only comprises trades reported to trade repository (TR) in the EEA, i.e. excluding trades of EEA entities outside the EEA area (para 192).

ESMA concludes that none of the variations of the commodity clearing threshold analysed in the consultation paper would have a material impact on the share of NFCs and notional value below or above the clearing threshold (para. 195, 202 and 209). This conclusion is flawed for several reasons:

* ESMA uses a static approach which takes the trading behaviour of NFCs (with the given low level of CCT at €3 billion) as given, and only varies the level of the clearing threshold. This type of analysis is misleading since the trading behaviour of NFCs is not exogenous to the level of the CCT and depends on the level of the clearing threshold itself:
	+ NFC-s (98% of the companies) either have no significant derivative trading business or implement strict limits to avoid becoming NFC+ (to avoid costs, see above). These internal limits typically contain a safety margin which results in effective utilisation of the clearing threshold well below 100%. For example, a limit utilisation of 80% (€2.4 billion notional value for commodity derivatives) would still be outside the range analyses by ESMA (€2.5-4 billion). However, increasing the threshold by €1 billion would allow an NFC- with a utilisation limit of 80% to increase its derivatives trading volume from currently €2.4 billion (=80%\*€3 billion) to €3.2 billion (=80%\*€4 billion).
	+ The small fraction of NFC+ (2%, see Fig. 50) which incur significant costs for their NFC+ status (see our response to Q4). Becoming an NFC+ is therefore only commercially sensible if these companies exceed the threshold by a significant margin to compensate for the additional NFC+ costs. Otherwise, an NFC could limit its derivative trading to a value slightly below the clearing threshold and avoid the costs associated with NFC+ status. It is therefore a consequence of the current EMIR regulation that none of the NFC+ companies are within close range of the clearing threshold (they would rather tend to lie some distance below to accommodate some headroom). An increase of the commodity clearing threshold to a level comparable to other jurisdictions (for example $8 billion in the US) could incentivise current NFC+s to reduce their derivative trading in order to become an NFC-.
* ESMA also does not present the results as curves, showing when and by how much a certain amount would actually affect NFCs. Instead, ESMA reports only results for three points on that curve. It is not clear from this analysis where current derivatives volumes lie and at what level of the threshold changes would be expected. But at any rate, analysis based on static data that reflects companies’ behaviour under existing thresholds is relatively insignificant.
* The simulations conducted by ESMA also do not consider important recent developments: ESMA utilizing only trading data for the year 2020, before the surge in commodity prices such as for CO2, gas and electricity. This means that the volumes (as measured in energy units rather than €bn) of commodity derivates tradable needed to stay below the clearing threshold would be significantly lower in 2021. Due to the non-equivalence of UK exchanges – which are among the most liquid commodity exchanges worldwide – all trades there fall under future clearing thresholds. Eliminating UK trades from the analysed data (para. 31) does not enhance the comparability with future results (as claimed by ESMA) – instead these trading volumes should have been allocated to uncleared OTC trades (as they would be treated under current regulation). This would have brought NFCs closer or even above the clearing threshold.

If ESMA wants to analyse the impact of higher clearing thresholds, it needs to consider the effects of clearing thresholds on trading behaviour. For example, this could be captured in a like-for-like comparison with NFCs in other jurisdictions with higher thresholds (for example, the US, Singapore and Australia).

<ESMA\_QUESTION\_DP\_EMIR\_CTs\_13>

1. For further information on the development of NBP and TTF: <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2020/05/European-Traded-gas-hubs-the-supremacy-of-TTF.pdf>. [↑](#footnote-ref-2)