CMCE – European Commission EMIR Review CP Response (draft 1)

Q1.2a	**i. Are the clearing thresholds for non-hedging transactions (Article 11, Regulation (EU) No 149/2013) and the corresponding definition of contracts objectively measurable as reducing risks directly relating the commercial activity or treasury financing activity (Article 10, Regulation (EU) No 149/2013) adequately defined to capture those non-financial counterparties that should be deemed as systemically important?** No. CMCE considers that the Article 10 EMIR methodology captures non-financial counterparties (NFCs) whose relevant positions in OTC derivative contracts pose no material market risk and which cannot be reasonably termed "systemically important". We see four principal faults with the methodology: 1. The Article 2(7) EMIR definition of "OTC derivative" is extremely broad and at odds with the objectives of the legislation. It includes without justification standardised derivative contracts executed on multilateral trading facilities (MTFs) that must be cleared by a central counterparty. In the absence of a Commission or ESMA list of equivalent third country markets, it extends to every derivative contract executed on every market outside the European Union. As a result, NFCs must currently aggregate positions in derivatives executed on third country markets not considered objectively measurable as reducing risks directly relating the commercial activity or treasury financing activity. 2. Article 10(3) EMIR requires NFCs to aggregate the non-hedge positions of all other "non-financial entities" within its group. This requirement extends to group affiliates established in third countries, which are generally subject to third country regulation on OTC derivative contracts. As a result, NFCs are often obliged to aggregate positions with no bearing on EU markets and that are subject to third country regulation. 3. The Article 10 EMIR exemption for contracts objectively measurable as reducing risks directly relating the commercial activity or treasury financing activity is undermined by the current ESMA guidance on macro and portfolio hedging positions. This guidance is inconsistent with Article 10 CDR 149/2013, includes requirements with no legal basis and is unfit for purpose. Several national competent authorities have applied this guidance to the letter and obliged NFCs to aggregate macro and portfolio hedging positions because these positions cannot be deconstructed contract-by-contract per the ESMA guidance. 4. The Article 11 CDR 149/2013 thresholds are inordinately low. The EUR 3 billion gross national value (GNV) thresholds for OTC interest rate derivatives and foreign exchange derivatives constitute respectively 0.000005% and 0.00004% of the total GNV outstanding as of according the Bank of International Settlements (BIS) end-December 2014 report [link]. Given the definition, aggregation requirements and current

	ESMA guidance, it is unsurprising that many commodity firms that exceed clearing thresholds do so with regard to interest rate and foreign exchange derivatives used predominantly for risk management and group treasury purposes. We note the Recital 29 EMIR direction to the Commission to "assess the systemic importance of the transactions of non-financial entities in OTC derivative contracts in different sectors, including the energy sector". We recognise the challenges of completing this assessment by the 17 August deadline. We encourage the Commission to consider the above faults in the methodology in this assessment and to make this assessment public upon completion. **ii. If your answer to question i. is no, what alternative methodology or thresholds could be considered to ensure that only systemically important non-financial counterparties are captured by higher requirements under EMIR?** We believe that amendments Article 10, related EMIR provisions and the current ESMA guidance on macro and portfolio hedging positions would greatly improve the methodology and refine the identification of NFCs that may pose systemic risk. We propose the following amendments for the Commission's consideration, which are set out in detail in the enclosed appendix: 1. Article 2(7) EMIR: we advocate adding the terms "multilateral trading facility" and "organised trading facility" to the definition to exclude derivative contracts executed on those trading venues from the definition; 2. Article 10(3) EMIR: we advocate replacing the term "non-financial entities" with the term "non-financial counterparties" to limit aggregation to persons established in an EU Member State; and 3. Article 11 CDR 149/2013: we advocate raising thresholds (c) (interest rate derivatives), (d) (foreign exchange derivatives) and (e) (commodity and other derivative contracts) to EUR 5 billion. In addition, we ask the Commission to request ESMA to review the current EMIR Q&A guidance. We believe that criterion (i) at OTC Answer 10(c) is contrary to the express direction of Article 10(1) CDR 149/2013 with regard to "derivatives […] by itself or in combination with other derivative contracts". We believe that criterion (iii) should be amended to delete the third and fourth sentences, which include requirements that are inappropriate for macro and portfolio hedges and have no basis in Article 10 CDR 149/2013.
Q1.2b	**Please explain your views on any elements of EMIR that you believe have created unintended consequences for non-financial counterparties? How could these be addressed?** We consider the following to be unintended consequences of the legislation, which result in more NFCs required to clearing OTC derivative

	contracts and some NFCs being required to do sooner than the agreed three-year phase-in for these counterparties: 1. Principle of "breach one, clear all" We see no legal basis for the principle of "breach one, clear all" as set out in Recital 25 of CDR 149/2013. We consider the justification provided in the recital to be counterintuitive. We believe that the unsophisticated nature of NFCs mitigates against requiring those breaching a threshold to clear all derivative contracts subject to the Clearing Obligation. We caution that given the faults to the Article 10 EMIR methodology cited above, this problem is far more widespread than the Commission may have considered in adopting the technical standard for Article 10(4) EMIR in 2012. 2. Counting of intragroup transactions We are frustrated by the requirements to count intragroup transactions for the purposes of the Article 10 EMIR methodology. We see little justification for the double counting of NFC-NFC intragroup transactions that for any of a number of reasons cannot be considered within the ambit of the Article 10 CDR 149/2013 hedging exemption. We see even less justification for the triple counting of these transactions where one NFC in the group backs off the transaction with a separate transaction with a third party. We do not believe that this double and triple counting of transactions for the purposes of the Article 10 EMIR methodology an intended consequence of the legislation. 3. Treatment of total return swaps We question the logic of treating total return swaps executed between group affiliates as OTC derivatives subject to reporting, clearing and/or risk mitigation requirements. It can be difficult to match these bespoke contracts to specific commercial activity or treasury financing activity within the parameters of Article 10 CDR 149/2013. We see little reason on the basis of systemic risk to apply onerous EMIR requirements to such contracts. 4. Proposed categorisation of counterparties for application of the Clearing Obligation. We are concerned that NFCs in breach of a clearing threshold (NFC+) may be unwittingly categorised as so-called "Category 1" counterparties for the purposes of applying the Clearing Obligation. We note recitals 5 and 6 and Article 2 of the draft RTS for Article 5(2) EMIR adopted by the Commission on 06 August and the broad application of the Article 2(14) EMIR definition of "clearing member". We caution that NFCs are often clearing members of CCPs for the clearing of specific commodity derivative contracts or groups of contracts. NFC CCP members may not necessarily clear any OTC derivative contract through the CCP and these persons should not be considered as either having OTC clearing arrangements in place or to engage in clearing OTC derivative contracts voluntarily. We do not believe it the intention of ESMA or the Commission to treat these CCP members as Category 1 counterparties but we fear that the draft technical standards, if adopted, may be interpreted in a manner that would compel NFC+ counterparties to clear contracts subject to the Clearing Obligation long ahead of the three-year deadline. We believe that these unintended consequences may be rectified through (a) amendments to recitals of the relevant Commission Delegated

	Regulation (or draft RTS), and (b) changes to the current ESMA Q&A guidance: 1. We urge the Commission to propose deleting Recital 25 of CDR 149/2013 and replacing this recital with an explanation that NFCs breaching a clearing threshold would be obliged to clear OTC derivatives of the relevant class in line with the deadlines in Article 10 EMIR. We do not believe that amendments to the EMIR legislation are required. 2. We ask the Commission to consider amendments to Recitals 22 and 23 of CDR 149/2013 to (a) confirm that non-hedge intragroup transactions should be counted once for the purposes of aggregation under Article 10 EMIR, and (b) exclude back off transactions with third parties. 3. We ask the Commission to seek clarifications in the ESMA Q&A guidance that would exclude total return swaps executed between two affiliates of the same group from aggregation under Article 10 EMIR as well as the Article 9 EMIR reporting requirement and Article 11 EMIR risk mitigation requirements. 4. We ask the Commission to support new ESMA Q&A guidance corresponding to the technical standards under Article 5(2) EMIR, which should confirm that NFCs may demonstrate to national competent authorities that any clearing membership of a CCP does not extend to a category of OTC derivatives subject to the Clearing Obligation.
Q1.2c	**Has EMIR impacted the use of, or access to, OTC derivatives by non-financial firms? Please provide evidence or specific examples of observed changes.** Yes. The Article 2(7) EMIR definition coupled with the absence of a Commission or ESMA list of equivalent third country markets has and continues to dissuade NFCs from transacting in derivative contracts executed on MTFs and third country markets. We note various reports of NFCs selling down positions in derivative contracts executed on third country markets so as to avoid breaching a clearing thresholds. Given the deficiencies in the ESMA Q&A guidance on macro and portfolio hedging summarised above, this restricted use of derivative contracts risks undermining risk management for production, merchandising and consumption of physical commodities produced and delivered outside of the EU. We do not believe that EMIR was intended to have a protectionist effect and we fear other jurisdictions acting in retaliation. We believe that the Commission can address these changes by publishing a list of equivalent third country markets without further delay. Furthermore, we are concerned by the application of Article 26 CDR 153/2013 and the minimum two-day margin requirement. We believe that this requirement substantially increases the costs of trading and clearing cost for NFCs and will drive liquidity to non-EU trading venues. We ask the Commission to reconsider the minimum two-day margin requirement and consider derogations from this requirement reflecting any agreement with US regulators to facilitate an implementing act under Article 25(6) EMIR.

Q1.5b	**i. Is the spectrum of eligible collateral appropriate to strike the right balance between the liquidity needs of the CCP and its participants?** No. **ii. If your answer to i. is no, for what reasons? How could it be improved?** We share the concerns of electricity and gas market participants as to the expiry of the derogation in Article 62(2) CDR 153/2013. We believe that eligible collateral arrangements in electricity and gas markets have functioned well since application of the EMIR requirements on collateral and we see little justification on the basis of systemic risk to let the derogation expire. However, we consider the justification for this derogation in Recital 43 of CDR 153/2013 is equally applicable to agricultural, oil, coal, freight, base metal and soft commodity markets. These markets are similarly linked to related spot markets and these markets are predominantly used by non-commercial producers and consumers of the relevant commodity. The derogation provides a competitive advantage for NFC clearing members trading certain wholesale energy products. We believe that making the derogation permanent and extending it to NFC clearing members trading contracts within the ambit of MiFID 2 Annex I Sections C5, C6, C7, C10, C11 would incentivise more self-clearing. We ask the Commission to support amendments to Article 62 CDR 153/2013 to make the derogation permanent and to extend it to other commodity derivative market participants eligible to use bank guarantees as eligible collateral.

General Questions

Q2.1	**i. Are there any provisions or definitions contained within Article 1 and 2 of EMIR that have created unintended consequences in terms of the scope of contracts or entities that are covered by the requirements?** Yes. **ii. If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?** Please see our answer to questions 1.2(a) and (b) above.
Q2.3	**i. Are there any significant ongoing impediments or unintended consequences with respect to meeting trade reporting obligations in accordance with Article 9 of EMIR?** Yes. **ii. If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?** We see five (5) ongoing impediments and/or unintended consequences affecting application of the Article 9 EMIR obligation. We believe that the Commission could address these ongoing impediments and/or unintended consequences in the main through limited and proportionate amendments to Article 9 EMIR and related implementing measures. 1. Dual-sided reporting of derivative contracts We question the utility of dual-sided reporting. We consider that this is often an unnecessary regulatory burden for NFCs. We ask the Commission to consider amendments to Article 9 EMIR to apply the reporting obligation to (a) the FC in cases of transactions between a FC and a NFC, and (b) the volunteering NFC in cases of transactions between two NFCs. 2. Reporting of exchange-traded derivatives (ETDs) We also question the utility of holding counterparties responsible for the reporting of ETDs. We believe that a CCP should be responsible for the reporting of an ETD that is cleared through its systems. In turn, general clearing members should be responsible for reporting back off transactions with their clients. We ask the Commission to reconsider applying the Article 9 EMIR reporting obligation to all transactions in the chain where non-

Comment [A1]: We may need more input from CMCE members to develop this argument

	clearing members or other persons enter into an ETD. 3. Historical reporting of closed-out or expired contracts We see no value whatsoever in backloading reports to trade repositories on contracts that have since been closed out or have expired. We consider this a significant administrative cost for counterparties for little appreciable benefit in terms of market supervision. We also fear that reconciling backloaded transactions will be extremely difficult to reconcile. We ask the Commission to support an amendment deleting Article 5(4) CIR 1247/2012. 4. Varying TR field definitions and quality checks We are concerned that the reconciliation of reported data is unduly complicated by the differing interpretations of field definitions and the different quality checks applied by trade repositories. We believe there is a clear need for common definitions and harmonised quality checks. We ask the Commission to consider amendments to CDR 150/2013 to promoting more consistent approaches to field definitions and quality checks amongst trade repositories and to promote better quality reporting by trade repositories to counterparties. 5. Reporting of Intergroup Transactions We are concerned that reporting of intragroup transactions creates a significant burden for many NFC's and note that in the USA NFCs have been exempted from similar requirements. We urge the Commission to introduce an exemption for Article 9 reporting for intragroup transactions between NFCs that comply with Article 3 requirements. 5. Overlapping reporting requirements (REMIT, EMIR and MiFIR) We are greatly concerned by the proliferation of disparate and overlapping reporting requirements applicable to derivative contracts in Union legislation. We note as electricity and gas derivative contracts as an unfortunate example of instruments, transactions in which are reportable not only under Article 9 EMIR but also under Article 8 of Regulation 1227/2011 on wholesale energy market integrity and transparency (REMIT) as well as (for certain counterparties) Article 26 of Regulation 600/2014 on markets in financial instruments (MiFIR). We urge the Commission to consolidate these overlapping reporting requirements in a single legal instrument with common definitions, fields and reporting mechanisms.
Q2.4	**i. Are there any significant ongoing impediments or unintended consequences with respect to meeting risk mitigation obligations in accordance with Articles 11(1) and (2) of EMIR?**

	Yes. **ii. If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?** We consider the use of different unique trade identifiers (UTIs) by credit institutions a major impediment to reconciling portfolios as required under Article 11(1)(a) EMIR. We ask the Commission to consider amendments to CDR 149/2013 to require a common approach to generating and using UTIs. We are also concerned that credit institutions using their own proprietary interest rate curves is frustrating the efforts of their counterparties to mark-to-market as required by Article 11(2) EMIR. We ask the Commission to consider amendments to CDR 149/2013 to encourage the appropriate sharing of data to facilitate EMIR compliance.
Q2.5	**i. Are there any significant ongoing impediments or unintended consequences anticipated with respect to meeting obligations to exchange collateral in accordance with Article 11(3) under EMIR?** Yes. **ii. If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?** We have reservations as to the deadlines for the exchange of collateral set out in draft RTS for Article 11(15) EMIR. For complex transactions in physical commodities, the proposed T+1 deadline would be very ambitious and would be difficult, if not impossible, to achieve. We ask the Commission to support amendments to the draft RTS to include an extension to T+3 for such complex transactions.
Q2.6a	**i. With respect to activities involving counterparties established in third country jurisdictions; are there any provisions or definitions within EMIR that pose challenges for EU entities when transacting on a cross-border basis?** Yes. **ii. If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?** We are disappointed that almost three years after the entry into force of the EMIR legislation the Commission has yet to adopt a single implementing act recognising the equivalence of legal, supervisory and enforcement arrangements of a third country jurisdiction under Article 13(2) EMIR. The absence of such secondary legislation risks the application of the Clearing Obligation and risk mitigation requirements and places

	persons established in the Union at a material disadvantage to non-EU market participants with regard to costs of trading and clearing. We urge the Commission to speed up implementing acts where jurisdictions have adopted legislation in line with G20 commitments and to consider adopting implementing acts contingent on the expected adoption of legislation where appropriate.
Q2.6b	**i. Are there any provisions within EMIR that create a disadvantage for EU counterparties over non-EU entities?** Yes. **ii. If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?** Please see our answer to questions Q1.2(a), (b) and (c), Q2.3 and 2.6(a) above.