Commodity Markets Council - Europe

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EMIR REFIT: Non-financial commodity market participants call for support to European Parliament position on collateral, intra-group exemption and calculation of positions against clearing thresholds for non-financial counterparties ahead of trilogues

Members of the Commodity Markets Council – Europe (CMCE) welcome the Commission's EMIR REFIT proposal[1] as a step towards making EMIR requirements more proportionate for non-financial counterparties ('NFCs'). However, the Commission's objective of easing the application of EMIR to NFCs will not be materially achieved if the status quo prevails for reporting of exchange-traded derivative transactions and the margin requirement for uncleared OTC trades.

Ahead of the trilogue negotiations, CMCE takes the following position:

Reporting obligation

CMCE Members welcome the delegation of the reporting obligation for OTC derivative contracts from NFCs that have not breached the clearing thresholds to financial counterpartis ('FCs'). However, we regret that both the Council and European Parliament positions fail to address the disproportionate burden that **reporting of ETD transactions** currently places on NFCs that use derivatives mainly to manage the commercial and financing risks that arise from their real economy activities. This is of significant importance, given that the bulk of transactions currently reported by NFCs are ETDs.

As regards the exemption from the reporting obligation for **intra-group transactions** involving NCFs, CMCE members support the European Parliament position, which extends the exemption to transactions where one of the counterparties is an NFC or would be an NFC if established in the EU. We do not believe that there is a justification for restricting the exemption only to transactions between two NFCs, given that in the case of an intra-group NFC-FC transaction the outward facing entity's transaction with a FC will in any case be reported.

Collateral requirement for OTC derivative transactions

CMCE Members welcome the European Parliament position which provides relief to NFCs by only obliging NFCs to post collateral for OTC derivative transactions in the asset classes in which the NFC has exceeded one of the clearing thresholds. This would be consistent with the restriction of the

[1] Proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories, 4 May 2017

clearing obligation for NFCs to the classes of OTC derivatives for which the clearing threshold has been exceeded.

Currently the requirement to post collateral for uncleared OTC trades mostly impacts on FX and interest rate swaps which are used by NFCs almost exclusively for hedging purposes to protect against price risks related to the financing of their physical operations. The requirement to hold collateral against these positions impacts on the cost of financing these physical operations, thereby implicitly **penalising the hedging activity**. It may also translate into **lost benefits for the broader economy** if investments in physical operations are re-evaluated as a consequence.

We believe that the removal of the margin requirement for FX and interest rate instruments that are traded with NFCs that exceed the clearing threshold would not pose significant additional risks to the market, given that the portion of these trades is small enough to **not be of systemic relevance** within the broader markets.[2] Removing the collateral requirement for these contracts would also be in line with the BCBS / IOSCO framework that recommends excluding non-systemically important non-financial entities from the margin requirements for non-cleared OTC derivative trades.

The collateral requirement will also increase the potential of multi-national groups **relocating** their affected central treasury functions or relevant hedging and financing activities to other jurisdictions where that activity would not be subject to margin requirements for uncleared OTC derivative contracts.

Calculation of NFCs positions against the clearing thresholds

CMC Europe members welcome the move away from the burdensome daily calculation of positions against the clearing thresholds which is supported by all three co-legislators. We nevertheless believe that the Commission and Council approach based on a calculation of March-April-May positions is too inflexible as that it could oblige NFCs to whom the clearing obligation applies to wait for a full year before they can have the clearing obligation dis-applied, based on an assessment only covering a three month period.

CMCE therefore welcomes and supports the European Parliament proposal suggesting that the annual calculation of positions be based on an aggregate month-end average position for the previous **12 months**.

<u>About CMC Europe</u>

CMC Europe is an industry association bringing together agriculture, energy, metals and other commodity market participants, price reporting agencies, and trading venues established and/or operating in the European Union (EU), the European Economic Area (EEA), Switzerland and neighbouring countries. CMC Europe represents non-financial firms whose main activity is sourcing, moving and trading physical commodities such as energy, agricultural products and metals across the globe to meet the needs of manufacturers and consumers. Our members trade large volumes of agricultural and energy commodity derivative contracts on European, US and other trading venues every day predominantly to hedge risks related to their commercial activities. CMC Europe members are therefore directly impacted by EMIR provisions on non-financial counterparties generally and on commodity derivatives in particular. For more information, visit www.commoditymkts.org/cmc-europe/.

[2] According to the Bank for International Settlement, non-financial customers accounted for under 3% of the global OTC interest rate derivatives market and for approximately 12% of the foreign exchange markets in the second half of 2016 (The calculations are based on notional amounts outstanding in the second half of 2016, BIS semi-annual OTC derivatives market statistics on the global OTC derivatives market, 17 September 2017 (see http://www.bis.org/statistics/d5_1.pdf). Considering that the vast majority of NFC activity is conducted by NFC-, only a small portion of these trades are transacted by non-financial counterparties that have breached the clearing threshold. The section of the market that would be impacted by a removal of the collateral requirement is therefore of no systemic relevance.