Commodity Markets Council - Europe

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To: Members of the European Parliament ECON Committee
Rue Wiertz, 1047 Brussels

Re: Non-financial commodity market participants call for support to Werner Langen's draft report on EMIR REFIT

Dear ECON Committee Member,

Members of the Commodity Markets Council – Europe (CMC Europe) welcome the Commission proposal to amend the European market infrastructure regulation (EMIR)[1] as a step towards making its requirements more proportionate for non-financial companies. 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.

The implementation of the EMIR reporting, clearing and collateral requirements is currently disproportionately burdensome for these non-financial firms that use derivatives mainly to manage the commercial and financing risks that arise from their real economy activities.

CMC Europe Members therefore welcome the important changes proposed by the Commission and endorsed and strengthened by the European Parliament rapporteur, Werner Langen in his draft report, to ease the burden of these requirements on non-financial counterparties (NFC).

CMC Europe Members call on Members of the ECON Committee to support the following changes to EMIR in order to ensure that the reporting, clearing and risk mitigation requirements do not disproportionately burden non-financial, real economy actors:

As per the Commission proposal (for more detail, see section 1 of Annex 1):

- Make CCPs responsible for **reporting exchange-traded derivative** (ETD) transactions on behalf of both counterparties. This is of significant importance, given that the bulk of transactions currently reported by NFCs are ETDs.
- Make financial counterparties (FC) responsible for **reporting OTC derivative** contracts on behalf of NFCs that have not exceeded the clearing threshold. To meaningfully ease the burden for NFCs, it is important that the obligation and liability for reporting clearly rests with the FC

[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

and that detailed or blanket requirements on NFCs to provide information to FCs are avoided – otherwise the burden of reporting risks in practice falling on the NFC.

- Exempt **intra-group transactions** involving an NFC from the reporting obligation. We welcome the Council proposal to extend this exemption to third country entities that are part of the same NFC's group. However, we regret that the Council position restricts this exemption to transactions where *both* counterparties are NFCs. Given that the outward facing entity's transaction with a FC will in any case be reported, we believe there is no significant added value to also reporting the corresponding internal transaction.

As per the Rapporteur's draft report:

- Amend EMIR so that NFCs exceeding the clearing threshold would only be subject to the requirement to **exchange collateral** for OTC trades in asset classes where the clearing obligation has been exceeded (see section 3 below). This would be consistent with the restriction of the clearing obligation for NFCs to the classes of OTC derivatives for which the clearing threshold has been exceeded, and would 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.

We also ask for legislators' support to introduce a small change to the methodology for calculating NFCs' positions against the clearing thresholds to avoid unintentionally making the system inpractical for NFCs (see more detail in section 2 of Annex 1).

We ask that where an NFC has exceeded a clearing threshold on the basis of the March-April-May annual calculation as proposed by the Commission, **NFCs should have the option to perform the calculation of positions against the clearing thresholds more frequently** (e.g. quarterly) to avoid having to wait for a full year before it can have the clearing obligation dis-applied.

One of the key objectives of the EMIR REFIT proposal is to simplify the application of EMIR and remove disproportionate burdens on non-financial firms. We call on the European Parliament to take a strong position that amends the EMIR framework so as to achieve this objective.

We remain at your disposal to further discuss this important proposal.

Yours sincerely,

Samina Anwar,

CMC Europe Chair

<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. 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/.

Annex I – Additional detail on the CMC Europe position on EMIR REFIT:

1. Reporting requirements on NFCs

CMC Europe Members welcome the changes by the Commission and the ECON Committee Rapporteur that seek to ease the reporting burden for NFCs by:

- Making CCPs responsible for reporting exchange-traded derivative (ETD) transactions on behalf of both counterparties.
- Making financial counterparties (FC) responsible for reporting OTC derivative contracts on behalf of NFCs that have not exceeded the clearing threshold.
- Exempting intra-group transactions involving an NFC from the reporting obligation.

CMC Members are concerned that the **position taken by the Council** undermines the important Commission proposals to ease the reporting obligation for NFCs by removing the introduction of single sided **reporting of ETD transactions**. This is of significant importance, given that the bulk of transactions currently reported by NFCs are ETDs.

As regards the **reporting of OTC derivatives** by financial counterparties, we also believe it is essential to make clear that the obligation and liability for reporting rests with the FC. Failing that, the responsibility risks in practice falling back on the NFC. It is also important that any requirements on NFCs to provide additional details of the transaction to the reporting FC do not constitute a de facto obligation to provide detailed reports to FCs. A blanket requirement on NFCs to provide any information required by FCs would undermine the aim of easing the reporting burden on NFCs, and would lead to difficulties in the implementation of the new framework for NFCs.

At the same time, CMC Europe Members welcome the suggestion of the Council and of the Rapporteur to extend the **exemption for reporting of intra-group** transactions involving an NFC to third country entities of a group. However, we regret that the Council position restricts this exemption to transactions where *both* counterparties are NFCs. Given that the outward facing entity's transaction with a FC will in any case be reported, we believe there is no significant added value to also reporting the corresponding internal transaction.

2. Annual calculation of NFCs positions against the clearing thresholds

CMC Europe members welcome that the Commission's proposal amending Article 10(1) moves away from the burdensome daily calculation of positions against the clearing thresholds and proposes that the calculation of positions be performed one a year on the basis of an aggregate month-end average position over three months.

However, CMC Europe members are concerned about the **inflexibility** of the procedure proposed for demonstrating that a NFC+ no longer exceeds the clearing threshold. **The Commission proposal would oblige the NFC+ to wait for at least a full year before it can have the clearing obligation dis-applied.**

This is problematic and could lead to situations where an entity will have to comply with both the clearing obligation and the collateral requirement for uncleared trades for a full year because of temporarily having come above the clearing threshold in one asset class.

We would therefore suggest that the proposed framework be amended to provide for the option to perform the calculation of positions against the clearing thresholds more frequently where an NFC has exceeded a clearing threshold on the basis of the March-April-May annual calculation. We suggest that this could be done on the basis of an **aggregate month-end average position over the last three months that would be performed quarterly**. The same approach should be applied for an NFC+ to deregister from the clearing obligation.

3. Collateral requirements for uncleared OTC derivative transactions

CMC Europe members welcome the proposal of the Rapporteur to amend EMIR so that NFCs exceeding the clearing threshold would only be subject to the requirement to exchange collateral for OTC trades in asset classes where the clearing obligation has been exceeded.

This would be consistent with the restriction of the clearing obligation for non NFCs to the classes of OTC derivatives for which the clearing threshold has been exceeded.

Currently this requirement 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.

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[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.