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EuropeanIssuers' Position Paper on the European Commission's Proposal for amending EMIR

March 2023

EuropeanIssuers (EI) welcomes the legislative proposal of the European Commission (EC) amending EMIR, as achieving a stronger EU clearing system actually represents a relevant development in view of the EU Capital Markets Union action plan.

EI acknowledges and supports the main objectives addressed by the EC in this legislative proposal in terms of improving attractiveness of EU CCPs, enhance resilience and reduce excessive reliance of EU clearing ecosystem, in view of EU's open strategic autonomy. However, EI highlights that the envisaged additional level of supervisory control should not translate into additional costs and burden for the clients of EU clearing, not to jeopardise its attractiveness.

Clearing services are a significant part of EU financial services market, and, as for the other financial services, their attractiveness increases by improving both the offer side (e.g. streamlining process and time to market for launching new products) and the demand side (e.g. increasing choice, competition, transparency).

Non-Financial Counterparties (NFCs) especially from the commodity sector represent a relevant part of the demand side for clearing services, as clients of CCPs for clearing financial derivatives used for hedging their treasury exposures (interest rates and foreign exchange rates) and commodity exposures (energy, metal and agricultural).

Nevertheless, EI strongly opposes the proposal for removing the intragroup reporting exemption.

Main concerns of NFCs regarding clearing services focus on:

Cost effectiveness: in fact, the trend of increased volumes cleared by CCPs combined with the very high levels of volatility experienced recently on energy markets and interest rates resulted in a significant growth of average cash margin calls for NFCs on their hedging derivatives. The global amount of cash required for clearing services can easily reach the order of magnitude of billions EUR for a medium/large NFC. Therefore, cost of financing the cash required for clearing is becoming a relevant share of total NFCs financial costs.

Any action aimed at **reducing the cost of collateral and increase the flexibility of collateral** used for clearing would result in an increased attractiveness for the demand side.

Predictability and forward planning of margin calls: margin calls are exchanged with CCPs on a daily basis and, taking into account the relevant size of collateral movements, a precise planning is required in order to cover the cash needs. Margin calls, if underestimated, can trigger very dangerous cash unbalances in term of systemic risk or, on the contrary, if overestimated, can result in very expensive credit costs for NFCs.

Any action aimed at **improving the predictability and the forward planning of margin calls** would result in increased attractiveness and in reduced systemic risk for the clearing services.

Ease of use in term of processes, IT systems and compliance: clearing via CCPs requires exchange of relevant amounts of cash and cash equivalent collaterals with intra-day frequency within strict financial markets closing deadlines. Therefore, for NFCs' treasury departments, clearing is a very burdensome process, requiring reliable and efficient IT systems, in-house or outsourced, and compliance to all EMIR reporting and risk mitigation techniques with daily calculations and reporting information flows.

Any action aimed at **improving the ease of use of CCPs** would result in increased attractiveness and in enhanced robustness of clearing services.

In view of the above, **EI supports the following proposals** amending current EMIR framework and aiming at:

- **clarifying intragroup transactions definition**, by making reference to a clear exclusion list;
- **simplifying clearing thresholds' calculation**, by eliminating cleared OTC derivative contracts;
- **reviewing clearing thresholds** for taking into account market fluctuations and more granular asset classes;
- **increasing collateral requirements' flexibility** by allowing bank guarantees and public guarantees as eligible collaterals;
- **improve margin calls predictability and forward planning**, by transferring models and information for initial and variation margins' calculation to CCPs clients.

On the contrary, in view of the above, **EI strongly opposes the proposal for removing intragroup reporting exemption**, that was already analysed in details and approved during past trilogue amongst European Institutions for EMIR REFIT.

More in particular, with reference to amendments to Regulation (EU) No 648/2012 included in current proposal:

I. Reporting obligation (new Art. 9):

   EI strongly opposes Article 9 amendment to remove the exemption from reporting requirements for transactions between counterparties within a group, where at least one of the counterparties is a non-financial counterparty.

   As stated in the *"Introduction of the Communication from the Commission to the European Parliament, the Council, the European Central Bank and the European Economic and Social Committee"*, risk centralization through intragroup derivatives has for industrial groups of NFCs the same beneficial role that clearing via CCPs has for EU markets. In facts, through intragroup derivatives a single specialized group's entity is able to interface the derivatives markets with a single net position, instead of managing a complex, risky and expensive network of bilateral exposures between each single group's subsidiary and the financial markets (i.e. CCPs and FCs).

   With risk concentration through intragroup transactions, large groups of NFCs are securing relevant advantages to financial markets in term of:

- level of risk and cost of hedging, since exposures and therefore margin calls are drastically reduced to the real net position at group level,
- professionalism and competences, since centralized entities are specialized in interfacing financial markets, guaranteeing the required know-how without involving pure industrial entities,
- economy of scale (concentration of risk exposure reduces both investment and running costs for systems and procedures) and compliance (specialized entities have the right know-how for financial regulation compliance and for supporting regulators).

Intragroup transactions are used only to transfer and to net risk exposures at group level; therefore, they do not pose any credit/systemic risk for markets. On the contrary, without intragroup transactions, industrial groups would bring on the markets unnecessary internal exposures, which could multiply by orders of magnitude cash required for clearing.

For the reasons above, risk centralization through intragroup transactions should be incentivized and compliance requirements and costs should be minimized. Intragroup reporting is a very burdensome and expensive compliance for NFCs and it would be even more now, after NFCs having passed a very burdensome process for requesting exemption at single Country level and with new investments required by new reporting formats.

Recital (14) explains that:" The exemption for those transactions from reporting requirements has, however, limited the ability of ESMA, the ESRB and other authorities to clearly identify and assess the risks taken by non-financial counterparties. To ensure more visibility on intragroup transactions, considering their potential interconnectedness with the rest of the financial system and taking into account recent market developments, in particular strains on energy markets as a result of Russia's unprovoked and unjustified aggression against Ukraine, that exemption should be removed."

With respect to past analysis and approval of the exemption already granted with EMIR REFIT in 2019, no additional elements have emerged but the mentioned "strains on energy markets as a result of Russia's unprovoked and unjustified aggression against Ukraine ".

It is very difficult for market participants to understand the link between energy markets crisis and reporting of intragroup transactions by NFCs, especially taking into account that for the relevant commodities affected by volatility spikes, i.e. natural gas and power, reporting is compulsory not only for financial derivatives contracts under EMIR to ESMA, but also for wholesale energy transactions and orders under REMIT to ACER. It is a concern for energy market participants to understand that the relevant amount of information currently available through EMIR and REMIT reporting is not fit for purposes.

According to REMIT, intra-group transactions are to be reported only upon request and on an ad-hoc basis. We wonder why intra-group transactions are not required to be reported under REMIT, which clearly focuses on the reporting of wholesale energy instruments, but should be reported under EMIR in future. On a further note, the existing exemption provides a level playing field with corporates in the U.S. because their regulator does not require the reporting of intra-group transactions.

EI suggests to maintain current exemption and to open a discussion table with the relevant stakeholders in order to understand in practice which have been the missing information that limited ESMA, ESRB and other authorities' visibility and for which analysis/calculation they are required, so to guarantee transparency for both authorities and market participants.

II. Intragroup transactions (new Art. 3): the new definitions of intragroup transactions for non-financial counterparty (Art. 3.1) and financial counterparty (Art. 3.2) provide for exclusion of entities established in third country not listed pursuant to par. 4 and 5. New intragroup definition still allows for non-financial groups using a regulated financial entity for centralizing risk, intragroup transactions or other financial services (e.g. collections/payments services, insurance etc.). EI supports the purpose of new definitions, i.e. to provide more legal certainty and predictability concerning the framework for intragroup decisions; hence, the need for an equivalence decision is replaced by a clear list of jurisdictions for which an exemption cannot be granted.

III. Clearing obligation for non-financial counterparties (new Art. 10):

Art. 10 (3) – In calculating positions counted against relevant clearing threshold, only contracts that are not cleared in an authorized CCP shall be included. The new calculation allows for exclusion of derivatives cleared in authorized CCP. Such exclusion is fair and supported by EI, since cleared derivatives are not posing credit risk to the system.

ESMA to draft regulatory technical standards for specifying:

Art. 10 (4) (a) – Updated hedging definition, i.e. "which OTC derivative contracts are objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity". EI highlights that any amendment of current definition must guarantee current exclusion from clearing obligation of all NFCs using financial derivatives for hedging purposes;

Art. 10 (4) (b) - Assessment values of clearing thresholds, of relevance for current OTC derivatives' classes (IR, FX, Credit & Equity) and of more granularity for commodity derivatives;

Art. 10 (4) (c) – mechanism triggering review of values of the clearing thresholds following significant price fluctuations;

for the above amendments Recital (16) by European Commission set objectives that are supported by EI, such as coherence of hedging definition with market developments, more granular approach for commodities classes allowing a differentiation amongst energy, metals and agriculture, values of thresholds updated on the basis of market volatility. EI also welcomes recommendation to ESMA to consult relevant stakeholders, that have specific knowledge on particular commodities. RTS wording will be crucial for guaranteeing consistency between set objectives and practical implementation.

IV. Risk-mitigation techniques for OTC derivative contracts not cleared by a CCP (new Art. 11):
EI supports Art. 11 amendment to provide non-financial counterparties, that become subject for the first time to the obligation to exchange collateral for OTC derivative contracts not

cleared by a CCP, with an implementation period of 4 months, in order to negotiate and test the arrangements to exchange collateral.

V. Participation Requirements (new Art. 37):

EI supports Art. 37 amendment to set out that where a CCP has on-boarded or intends to on-board non-financial counterparties as clearing members, that CCP should ensure that certain additional requirements on margin requirements and default funds are met. Hence, NFCs can still be clearing members, complying with specific requirements and keeping accounts at the CCP for assets and positions held for their own account.

VI. Transparency (new art. 38):

EI supports Art. 38 amendment in order to ensure that clients and indirect clients have better visibility and predictability of margin calls. Clearing members and clients providing clearing services should ensure transparency towards their clients. "Clearing members providing clearing services and clients providing clearing services shall inform their clients in a clear and transparent manner of the way the margin models of the CCP work, including in stress situations, and provide them with a simulation of the margin requirements they may be subject to under different scenarios. This shall include both the margins required by the CCP and any additional margins required by the clearing members and the clients providing clearing services themselves."

VII. Collateral requirements (new Art. 46):

EI supports Art. 46 amendment to allow bank guarantees and public guarantees to be considered eligible as highly liquid collateral, provided that they are unconditionally available upon request within the liquidation period and making sure a CCP takes them into account when calculating its overall exposure to the bank.

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