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European Commission

John BERRIGAN

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Subject: Eurelectric's remarks regarding the EU Commission's communication "Facing the energy crisis in the EU: work streams related to the financial system", incl. particular a response to the letter from ESMA dated 22 September 2022

Dear Mr. Berrigan,

The European power sector association, Eurelectric, strongly believes that it is key to have well-functioning, liquid, competitive, transparent and robust integrated energy markets to provide efficient price signals to market participants for generation dispatch and supply as well as for investment decisions. It supports the green transition and underpins the society by ensuring a secure, sustainable and competitive energy supply to end customers.

In this context, we would like to highlight that **EU energy companies such as power producers or energy supply companies are active in the EU energy markets to cover their supply and demand and to execute (derivative) transactions to mitigate the price risks of their commercial activities (hedging).** For example, the operator of a gas fired power plant must hedge its commercial risks (market risk), which consists of the constant change in value of the gas procured and of the produced power. Likewise, energy supply companies have to buy energy in advance to be able to offer to their retail customers gas and electricity at reliable, affordable prices. For these purposes, EU energy companies typically enter into transactions on centrally cleared, regulated EU energy exchanges, but also to some extent into collateralized bilateral transactions (OTC), e.g., the latter for tailor-made hedging of the specific commercial risk profile of a wind park operator.

In this respect, before entering into our detailed comments in relation to [ESMA response letter on 22nd September](#) regarding the current level of margins and of excessive volatility in energy derivatives markets, Eurelectric would like to react to the following ESMA's statement *"Considering the size and nature of the business of some of these entities, it would be useful to revise or replace the current test to ensure that the biggest entities are duly licensed and supervised as investment firms for their trading and investment service provision activities."*

Energy companies are active in financial (derivative) markets in order to manage their commercial risks. Such business is therefore very different than the one of a financial institutions which is providing investment services.

In other words, **energy companies are not equal to financial companies**, and it is important to remark the difference: the activity of energy companies arises from the need to properly address the risks stemming from the natural positions of energy companies.

- **This activity of non-financial energy firms is not of systemic importance to the wider financial system:** energy (derivatives) markets represent only a small proportion of the wider financial markets. Unlike major financial institutions, energy firms are not embedded in the complex web of the global financial system, and there is limited direct overlap or systemic interaction between the energy firms and major financial institutions
- **If the biggest entities had been subject to a MiFID license, the liquidity needs for such entities would have been even higher** due to extra EMIR mandatory margining and prudential capital requirements (under IFR/D). These extra capital requirements would have exacerbated the liquidity stress they are facing, reinforcing the volatility vortex.

The energy firm's activity in the commodities market is focused on hedging the risks of the natural positions derived from their core activity, these risks must be properly addressed to avoid any unintended consequence: in particular: discouraging risk, reducing liquidity and diverting capital away from crucial investment in energy infrastructure including renewables. We are concerned that the combination of these effects will undermine the development of a liberalised and integrated internal energy market and potentially further increase energy prices.

Building on input from experts active across the electricity value chain, we have listed below our more detailed comments regarding ESMA's response letter on 22nd September regarding the current level of margins and of excessive volatility in energy derivatives markets, in order to contribute to ongoing discussions and see how to best address the energy price crisis while ensuring a well-functioning energy market.

1. Increasing the EMIR Clearing threshold level is necessary

It is positive that ESMA proposes to increase the EMIR's threshold for triggering clearing of commodity derivatives. However, **Eurelectric believes that an increase from 3 to 4 bn does not fully reflect what is appropriate.** Indeed, Eurelectric is of the opinion that the current EMIR clearing threshold level is too low for three reasons:

- **It does not reflect the changed energy market conditions in 2022 as compared to 2012.** It has neither been adapted to the drastic increase in energy prices nor to the effects of Brexit on the re-classification of derivatives executed on UK markets as OTC derivatives.
- **It is not suited for facilitating the European energy transition and achieving the climate targets of the European Green Deal.** The European Green Deal requires hundreds of billions of euros' worth of investments in the energy sector in the current decade. Private investments in renewable energy will play a key role. As government support phases out, the availability of market-based opportunities for reducing risks (such as OTC derivative trading) becomes increasingly important to make new renewable investments financeable. However, the prevailing EMIR clearing threshold severely restricts non-financial (energy) companies from offering hedging solutions to renewable based energy companies/investors. For example, a single financial PPA, an over-the-counter derivative which is in the scope of EMIR, for a large-scale offshore wind park can lead to a company exceeding the clearing threshold of € 3 bn.
- **It puts EU energy companies at a competitive disadvantage** as EMIR provides the most restrictive regulatory standards for OTC commodity derivative markets regulation among G20 jurisdictions.

Eurelectric has not seen any evidence of the energy industry causing systemic risk for the financial sector and, hence, there should be sufficient headroom for a significant increase of the current threshold. Such significant increase would, thus, in the eyes of Eurelectric, still respect ESMA's mandate to avoid systemic risk for the financial sector (i.e. the CCP's at first hand) and would at the

same time be helpful for the liquidity in the market – having in mind that not least under current market situation an enhanced liquidity is even more needed to underpin the important hedging activities of energy companies.

2. Extension of eligible collateral to non-cash collateral as an important step

We welcome that ESMA acknowledges *“that the increased margin requirements and the difficulties of certain non-financial clearing members to secure sufficient liquidity to meet these requirements have led them, at least in some markets, to limit their hedging activities and consequently expose them to further risks.”* While we welcome ESMA’s support for the use of uncollateralized commercial bank guarantees under certain conditions, we want to emphasize that **an increase of eligible collateral should not only be regarded as a measure for non- financial clearing members but for all non-financial market participants regardless they are direct clearing members or post their collateral through a clearing member.** On the other hand, **this should not be a temporary measure. Thus, we strongly urge for an extension of eligible collateral to non-cash-based collateral such as non-fully backed bank guarantees and EU Emission Allowances (or other accredited instruments) on a permanent basis for all market participants.** Bank guarantees reflect the fact that energy companies have assets and a cash-flow and can, thereby, be said to be an appropriate method allowing the assets etc. to be substantiated into a bank guarantee. This will help market participants and clearing members to meet the margin calls of the clearing houses. Further, **we call on the Commission to extend the list of eligible collaterals to non-fully bank guarantees and EU Emission Allowances as part of the upcoming EMIR review, and ideally through a quick-fix process.** A more fundamental review of the EMIR Level 1 rules would – given the usual duration of Level 1 legislation proceedings – most likely not become effective before the beginning of 2025, which would be far too late in the light of the urgency to mitigate the energy crisis and to realise the energy transition by 2030. Last but not least, it is worth noting that such call is supported by the wider energy industry as well as clearing houses ([Statement 12th September](#)).

3. Transparency is needed and already existing

In ESMA’s response to the Commission, we were surprised to see that they indicate that there is a lack of transparency with regard to physical energy trading. **Potential shortcomings in market integrity of wholesale energy markets have been addressed through the Regulation for Market Integrity and Transparency (REMIT).** It introduced a framework to regulate insider dealing and market manipulation tailored on the needs and dynamics of wholesale energy markets. It is reasonable and proportionate response because it addresses the concerns that the energy market could create to the ‘real economy’ in question.

Energy companies are both subject to reporting obligations for financial derivatives as well as for physically traded commodities. If ESMA sees a need for also having insight to physically traded energy commodities in order to fulfill their supervisory duties in the financial market, we simply suggest that ESMA requests the required data to ACER. This said, we still believe that the supervision of the physical energy markets needs to stay at a sector specific body (ACER & hence through REMIT) having insights into these markets how they are interweaved in terms of production merit order and supply-and-demand-side interlinkage.

4. Circuit breakers can only be a measure of last resort

For market participants it is vital to keep the market (exchanges) open as long as possible, i.e. as long as a fair and orderly function of the market is given. It is key to have a market to allow to manage positions and risks at all times. **Halting the market would likely have many unintended consequences, therefore it can only happen as a measure of last resort.** This is why Eurelectric calls for a very cautious approach. This also requires a very transparent approach as regards criteria when a market is halted and very importantly also when it is re-started. It is also very important to recognize that energy markets/market places are very interlinked; to halt one exchange (i.e. a certain product) may have a negative impact on the overall position of a market participant (as a generator may sell power to and buy e.g. EUAs and gas at the same time to hedge the spread position of the generation).

We thank you for your attention. We would welcome the opportunity to further explain to you the above-mentioned points and would be grateful if you could propose to us suitable dates and times for a meeting in person or a video conference.

Should you have any questions, please do not hesitate to contact Johanna Keese (jkeese@eurelectric.org).

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Cillian O'Donoghue', with a long horizontal flourish extending to the right.

Cillian O'DONOGHUE

Director – Policy

C.c: Director-General Ditte Juul Jørgensen, DG Energy (ditte.juul-joergensen@ec.europa.eu)