# EU Contingency Action Plan should cover UK Regulated Markets

Avoiding risk management problems for non-financial companies hedging commodity price risks!

Joint associations' position on the EU Commission's Communication "Preparing for the withdrawal of the United Kingdom from the European Union on 30 March 2019: a Contingency Action Plan", 14 December 2018

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## EU Contingency Action Plan should cover UK Regulated Markets

The associations[1] urge the EU Commission to take all actions to avoid major cliff-edge effects in the event of a no-deal Brexit by guaranteeing functioning and effective financial markets, including commodity derivatives markets. This is of uppermost importance because of the reliance of real-economy firms on liquid commodity trading markets to effectively hedge their commodity price risks. In a no-deal Brexit scenario, it is important to recognise not only UK Central Counterparties (CCPs) as equivalent to those located in the EU but it is essential that the EU Commission publishes as soon as possible a temporary equivalence determination for UK Regulated Markets and, in turn, procure that ESMA confirms that these UK Regulated Markets are recognised under EMIR.

Therefore, we welcome very much the EU Commission's Communication of 13 November 2018 on Brexit Preparedeness. As regards financial services the EU Commisison states that it will soon adopt temporary equivalence decisions in order to ensure that there will be no disruption in central clearing and in depositaries services (CSDs).[2]

This is an important and helpful EU decision but we wish to raise a concern that the EU Commission's Communication makes no reference to the following plight of UK Regulated Markets (Exchanges): The Communication covers explicitly only UK CCPs and CSDs and this raises legal uncertainty on how and when the EU will recognise UK Regulated Markets (Exchanges) under EMIR as equivalent to those located in the EU. If the EU Commission does not take this action, this would cause significant problems for EU non-financial companies, including EU real-economy firms, who currently use UK Regulated Markets. They are essential for these firms as they host trading in commodities to a global audience including certain commodities that are not or are little traded on EU27 venues, including metal, oil, coal and gas.

A failure to recognise the equivalence of UK Regulated Markets is a risk for EU non-financial firms in a no-deal Brexit scenario because UK trading venues will become 3rd country venues.

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[1] Bundesverband der Deutschen Industrie, Bundesverband der Energie- und Wasserwirtschaft, Deutsches Aktieninstitut, EFET, Energy UK, Eurelectric, International Association of Oil & Gas Producers, Verband der Chemischen Industrie.

[2] See: European Commission Communication dated 13 November 2018 "Preparing for the withdrawal of the United Kingdom from the European Union on 30 March 2019: a Contingency Action Plan".

This inaction by EU authorities could trigger numerous additional burdensome obligations for EU non-financial firms under EMIR because derivatives that were categorised as Exchange Traded Derivatives ("ETDs") before Brexit, will be re-categorised as OTC derivatives ("OTCDs") after Brexit, when they will be traded over these inequivalent UK trading venues.[3]

We strongly urge the EU Commission to provide legal certainty and publish as soon as possible a temporary equivalence determination for UK Regulated Markets and, in turn, procure that ESMA confirms that these UK Regulated Markets, in particular UK commodity exchanges, are recognised under EMIR. If UK Regulated Markets would be deemed equivalent to EU Regulated Markets under EMIR, then the material adverse impact on EU non-financial firms caused by the re-categorisation of ETDs as OTCDs under EMIR could be avoided. Otherwise this re-categorisation of ETDs will cause a material adverse cliff-edge effect for EU non-financial companies, as it affects under EMIR (a) the determination of whether a non-financial firms exceeds the mandatory clearing threshold, (b) the scope of instruments that are subject to the mandatory clearing obligation, (c) the scope of instruments that are subject to the risk mitigation requirements, including mandatory collateralisation and (d) the way in which trades in these instruments are reported operationally.

EU non-financial companies that use commodity derivatives markets mainly or exclusively for risk management purposes qualify as NFC- and, consequently, they are not subject to mandatory clearing or collateralisation requirements under EMIR. In this respect, it is imperative that the gross notional value of transactions per class of OTC derivatives, which do not serve a hedging purpose, is below the EMIR clearing thresholds. This regulatory approach allows non-financial firms to use commodity derivatives markets for risk management purposes and to perform trading activities. Such a possibility has been introduced to increase liquidity in these markets in order to enable companies from all sectors to hedge their commodity price risks efficiently and economically.

A failure to recognise the equivalence of UK Regulated Markets would automatically lead to a re-categorisation of UK ETDs as OTCDs under EMIR and could force EU non-financial companies to reduce or stop their trading activities or/and to relocate parts to an EEA or recognised 3rd country trading venue (if possible). They could otherwise breach the clearing threshold in one asset class (e.g., commodities) and thus become NFC+ under the current EMIR legislation, and being subject to a mandatory clearing and collateralisation obligation for all asset classes (commodities, FX, IR) across the entire coporate group.

[3] See: European Commission Notice to Stakeholders dated 8 February 2018 on "Withdrawal of the United Kingdom and EU rules in the field of post-trade financial services".

In addition, many other EU non-financial firms who do not breach these thresholds would be impacted by high costs of compliance with the other EMIR obligations, because the scope of instruments that are subject to EMIR is expanded requiring additional reporting and risk mitigation requirements under Art. 11 EMIR (for derivatives, which are not cleared on a CCP) to be performed. Overall, it is questionable if market participants would be able to support these material changed workflows and costly requirements on and from 30 March 2019 onwards, which inadvertly would affect market liquidty.

Although in some instances, it may be possible to relocate some trading to the EEA or already recognised 3rd country venues (e.g. USA) in order not to breach the EMIR clearing thresholds, this may not be feasible for all commodities in particular metals, oil, coal and gas, leading to reduced liquidity for these commodities. In addition, in case of relocation to other trading venues in 3rd country jurisdictions, e.g. to U.S. trading venues, it can cause burdensome workflows (e.g. re-papering) and trigger 3rd country compliance obligations for non-financial firms.

Overall, reduced liquidity and increasing prices for these commodity derivatives traded by and for EU firms would be a real and possible consequence. This in turn could greatly impact the risk management of EU non-financial companies which use directly or indirectly UK commodity derivative markets to manage their commodity price risks. In particular, resource intensive industries such as those in the energy, metals or chemical sectors are directly affected. In the end without effective and economic risk management possibilities, consumers would need to pay higher energy and product prices.

We therefore urge the EU Commission to explicitly include the recognition of UK Regulated Markets under EMIR in its Contingency Action Plan in order to avoid serious risk management issues and additional costly EMIR obligations for EU non-financial companies in case of a hard Brexit.