Trade Registration ...

As a key to meeting the EMIR compliance challenge

By Peter Reitz

CLEARING THROUGH CENTRAL counterparties (CCPs) has served as a major risk mitigation mechanism in financial markets for many years. Its application in energy trading is more recent but has steadily grown in importance in recent years and continues to do so as many market participants increasingly value its advantages as an efficient anti-counterparty-default-risk instrument, its anonymity and the related post-settlement services.

The general trend towards clearing on the grounds of risk minimisation is now being reinforced, following the step-by-step implementation of the European Market Infrastructure Regulation (EMIR) that entered into force on August 16th 2012.

Although EMIR, first and foremost, constitutes a key part of the EU's regulatory response to the latest financial crisis and aims at preventing future failures of the international financial system, it also contains rules and provisions that directly impact the European energy trading community. In particular, this concerns the obligation to clear over-the-counter (OTC) derivative transactions for commodities. Furthermore, whilst a special three billion euro threshold is given for non-financial counterparties, everything beyond it has to be cleared mandatorily. Importantly, once the line is crossed in one asset class, the clearing obligation applies to all other asset classes as well.

Therefore, the new EMIR rules oblige energy traders to manage and monitor their trading activities against the background of the given threshold. This requires not only an administrative effort but also calls for instruments permitting effective threshold management through the voluntary clearing of OTC-derivative trades. A convenient option to do so is through Trade Registration – a service that is offered by the European Energy Exchange (EEX) and its clearing house, European Commodity Clearing (ECC).

Generally, Trade Registration allows for the conclusion of a deal, by means of registration within the systems of EEX, by mutual consent. As part of this, bilaterally agreed contracts will be converted into standardised exchange derivative contracts which are not considered OTC-derivatives under EMIR and therefore, do not count towards the three billion euro threshold calculation.

Looking at this in greater detail, the conversion can be done in two ways: one option is the conclusion of a trade via direct registration in the EEX system by mutual consent. The other is to replace an existing OTC transaction with a standardised exchange contract. The original OTC deal then ceases to exist, and will be fully replaced by an exchange contract.

Both possibilities of Trade Registration provide for full flexibility and can be used at the convenience of the involved trading participants. In addition to this, the registration process can be electronically supported via the EFETnet Clearing Registration Service (eXRP) as well as Trayport's Clearing Link.

What is EMIR?

At a major summit in Pittsburgh in 2009, leaders of the G20 countries addressed the root causes of the financial crisis and committed to tackle risks related to the derivative markets. In order to make that commitment effective, the European Parliament and the Council adopted the European Market Infrastructure Regulation (EMIR) on July 4th 2012. It requires OTC derivative contracts to be centrally cleared and reported. Additionally, it defines rules to enhance the safety of central counterparties (CCPs) and sets a framework for Trade Repositories (TRs). EMIR is directly applicable in all EU Member States. (Source: ESMA)

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This approach provides a number of benefits for OTC trading, the key advantage being legal certainty. Simply put, voluntary clearing avoids undesirable mandatory clearing. All contracts that are registered at EEX and cleared via ECC will not be taken into account for the calculation of the three billion euro EMIR threshold for commodity OTC derivatives, allowing for smooth and flexible portfolio management. As a result, it is on each trading company to decide when and which volume it wants to clear. Moreover, all other clearing benefits,

Straight Through Processing of OTC Transactions

As a central counterparty, ECC provides clearing services for transactions arranged outside the exchange in products registered at its partner exchanges, including EEX. In addition to offering manual Trade Registration, ECC also supports two mechanisms for the automatic registration of trades – straight through processing (STP) – via EFETnet and Trayport Ltd. as a service for the exchanges. With the EFETnet Clearing Registration Service (eXRP) and Trayport's Clearing Link, it is possible to use one single electronic portal for Trade Registration, monitoring of all Trade Registrations in real time and supporting the reconciliation of cleared positions. Currently already available on EEX, ECC will offer this service to other interested partner exchanges as well, starting in 2014.

including risk mitigation and post-settlement services as well as cross-commodity margining will of course also apply, helping to significantly reduce the overall costs for members.

The volume figures prove that EEX is on the right track. In the first half of 2013, EEX's trade registration volumes increased by 30% year-on-year and this trend is set to continue. Further to this, November saw a growing interest in trade registration with the first trade in Romanian Power Futures registered on EEX, for clearing via ECC. This follows on from the successful registration of the first Italian Power Futures, which were launched by EEX in October and have performed well ever since. Yet, ever conscious of the need to further expand its existing service, EEX currently also offers the registration of Swiss and Scandinavian power futures. This service will be extended to additional markets in the near future with a view to participants deriving potential saving effects in the margins to be deposited through cross margining.

EEX and ECC have put significant work and effort into compliance, namely by amending governance rules, policies and procedures in order to meet the new EMIR requirements. The granting of an EMIR licence will allow ECC to continue to provide its clearing services across Europe on a long term basis. ECC submitted its application form to become an EMIR regulated central counterparty to the German Financial Supervisory Authority (BaFin) in September 2013, and expects to receive its EMIR clearing licence in early 2014.

After all, EMIR indeed poses a significant new challenge to European energy trading. Nevertheless, it has now become a legal reality and must be complied with. In this context, Trade Registration at EEX for clearing via ECC constitutes an optimal tool to effective and efficient EMIR threshold management. •

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