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AMENDMENTS TO EMIR REGULATION NEEDED IMMEDIATELY

Nordic power prices have increased rapidly due to high power prices in Central Europe, low water reservoirs in Norway and Sweden, and the end of power import from Russia. As an example, as per the situation on 26 August 2022, Nasdaq electricity derivatives prices for 2023 had increased approximately 700 %, the EEX electricity prices 720 % and the TTF gas futures prices 550 % since February 2022. Very little volumes are traded on the market, which leads to large price movements even with small volume trades, which impact the margining requirements for all market participants. Thus, the market is currently not functioning.

The levels of collateral and cash margins needed have increased dramatically and now pose severe risks on the liquidity of the market participants - thereby creating consequences for the whole market and market set-up. This has led to several market participants ceasing hedging on the exchange and moving positions away from Nasdaq - to bilateral contracts without margining requirements - in order to decrease the level of required collateral and daily cash settlements.

In order to restore functioning markets swiftly, a public support scheme is urgently needed. That is, however, only temporary relief and only amendments to the EMIR¹ regulation and implementation easing collateral requirements for hedgers is a sustainable solution to prevent further worsening of the situation and potential crises in the future. Because legislative processes take time, the work should be started immediately. The major defect with current legislation is that no difference is made between the hedgers and speculators in respect of margining requirements. The hedgers have an underlying cashflow as they are hedging the production or sales of e.g. power against the price volatility in the market. Speculators, on the other hand, do not have any underlying production or sales that could be used as collateral.

EMIR in its current form already allows accepting the underlying of the derivative contract or the financial instrument as collateral to cover the margining requirements. Amendments to EMIR's implementation are, however, needed which will enable Nasdaq to change their rules in this respect. Such amendments are likely less complicated and could be accomplished faster than changing EMIR, as the EU Commission can alone adopt delegated regulations, thus this could be part of a shorter-term measure to be initiated swiftly. In the longer term-perspective, also other EMIR

¹ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (known as European Market Infrastructure Regulation).

changes should be initiated to enable lower and other types of collateral requirements for hedgers.

1. Hedgers should be allowed to place the underlying power as collateral

According to the wording in EMIR article 46.2: *“A CCP may accept, where appropriate and sufficiently prudent, the underlying of the derivative contract or the financial instrument that originates the CCP exposure as collateral to cover its margin requirements.* However, EMIR’s current regulatory technical standards² does not accept power or underlying cashflow as only e.g. gold, cash, government and high-quality corporate bonds and covered bonds are accepted as collateral. Consequently, Nasdaq does not accept this. Both EMIR’s regulatory technical standards and Nasdaq’s limitations should be challenged as too strict under EMIR. Taking into account the underlying cashflow with hedging, hedgers should be treated differently than speculators³. Amendment of a delegated regulation is most likely less complicated and could be accomplished faster than changing the EMIR regulation, as the EU Commission has power to adopt alone the delegated regulations. Still such a process is expected to take several months.

2. Other types of collaterals should be accepted for hedgers

The requirement that basically only cash is accepted as collateral is too strict and causing the withdrawal from the market. Main reason being that power production is asset heavy and cash reserves of utilities are limited. They have, however, valuable assets and other type of guarantees that could be provided. Therefore also other type of collateral should be accepted such as non-collateralized bank guarantees⁴ (which were accepted until 15 March 2016), emission rights or underlying assets.

3. Collateral Margin requirements should be lowered for hedgers

Lowering margining requirements for hedgers can be justified at least for the following reasons. Firstly, according to article 41.2⁵ of EMIR when the margin requirements are set, the risk characteristics of the products cleared should be taken into account. Since the risk profile of hedging derivatives is different, due to the underlying cashflow, from

² Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties

³ In order to prevent cash liquidity risks moving to the CCP level appropriate products are needed, such as deferred settlement futures or similar.

⁴ Non-collateralised bank guarantees are bank guarantees that are not fully backed by collateral. Fully collateralised bank guarantees are still accepted as collateral under EMIR.

⁵ *“A CCP shall adopt models and parameters in setting its margin requirements that capture the risk characteristics of the products cleared and take into account the interval between margin collections, market liquidity and the possibility of changes over the duration of the transaction”*

speculative derivatives it would be justified and reasonable to have lower margin requirements for hedgers.

Further, in order to ensure that the market is viable and liquid also in exceptional circumstances a possibility to lower thresholds should be introduced. Viable markets are a necessity to ensure predictability for all market players as well as final consumers.

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