5 April 2019

ISDA/FIA/GFMA general comment to the European Commission's consultation on the international role of the euro in the field of energy

The International Swaps and Derivatives Association (ISDA), FIA and GFMA (the "Associations") welcome the opportunity to respond to the consultation launched by the European Commission on the international role of the euro in the field of energy. In view of the fact that this consultation aims at gathering stakeholders' views on the best ways to implement the European Commission's Recommendation published in December 2018, the Associations outline their general comments.

The Associations find that a dialog including a wide range of stakeholders including market participants is of significant importance. Enhancing the international role of the euro should be seen as a gradual and long-term process closely linked to the global - and European - economic and market developments (including but not limited to infrastructure, competition issues, supply and demand side obstacles and factors).

The Associations have strong concerns that regulatory intervention in the currency used by market participants could lead to market fragmentation which in turn would lead to inefficiencies and higher costs for derivatives market participants, and ultimately to increased risk. The Associations have published position papers outlining such risk[1]. Energy markets and the currency used for transactions in those markets are commercially driven, as set out in more detail below. Legally enforced usage of the euro (i.e. switching to another currency) in transactions/operative processes for part of the business or for some instruments could lead to disruptions and EU firms being placed at a competitive disadvantage against their global peers.

It is important to take into account differences between commodity asset classes when looking at the international role of the euro. It is also essential to consider that the choice of currency in energy markets depends on various components. To mention some of these components:

- **Asset classes and Location:** commodity markets, especially oil markets, are international and commodities are generally priced according to requirements of the supply side. For example, the use of euro in transactions involving an oil producer located in the Middle East or the USA is unlikely. On the other hand, natural gas and power markets are more localised, and the use of currency is location specific: within the euro-zone, the use of euro is wide-spread, whereas

[1] Regulatory driven market fragmentation, ISDA, January 2019, https://www.isda.org/a/wpgME/Regulatory-Driven-Market-Fragmentation-January-2019-1.pdf and FIA warns of increased market fragmentation caused by regulation, March 2019, http://fia.org/articles/fia-warns-increased-market-fragmentation-caused-regulation

for cross-border trade the market generally uses USD. It is also important to note that there is a significant difference in the usage of the euro depending on where the business partners are placed in the supply chain. Upstream producers (e.g. crude oil providers, which are generally non-eurozone based) have their revenues and cost base mainly in USD, which is also reflected in their P+L reporting. On the other hand, euro-zone located downstream firms (e.g. electricity companies) have their revenue stream in euros and more of their cost base (labour, plant and equipment, rent and financing costs) is denominated in euros, generally reflected in their P+L reporting. There is already a shift to using the euro for downstream producers as a function of the energy clients' needs.

- **Customer needs:** the use of a given currency is often commercially driven by customers. For instance, a customer located in Europe but buying commodities, hedging, freight or insurance contracts for its commodity business with global counterparties would most likely require USD to operate in a global market. Euro-referenced products are unlikely to be of benefit to the customer. If EU financial services firms were obliged to sell euro-products to such customer due to relevant regulation, they would not be competitive with non-European financial service firms and the customer may have to take their business elsewhere. Furthermore, determining currency hedging products used for a customer is based on the portfolio of currency exposures the financial services provider is facing and not on individual trade flows.
- **Supply-chain:** the currency for single elements in a supply chain, including derivative markets, needs to reflect conditions set by the supply chain as a whole. For example, one cannot only consider the currency used for a commodity derivatives transaction between two European counterparties. Other factors to take into account are the currency used in the transaction for the physical underlying, which may include an international element and could be priced in USD, the related hedging to reduce exposure risk to a change in the (USD) price of the physical underlying, or freight and insurance contracts, which will need to cover a loss in the same currency as the insured product.
- **Benchmarks:** Benchmarks play a role in the currency of a product. For example, if the market prices a commodity in line with a certain benchmark that itself is published in USD, then derivative contracts referring to such benchmark price will likely use the currency of the benchmark.
- **(Lack of) business incentives to change the operational currency:** a group/company running its business in USD has little incentive to switch to euro for energy transactions. This is partly due to increased risk of fragmentation on different levels. Switching to another currency for part of the business or for some instruments without the market as a whole following could lead to disruptions. Further, switching partially to another currency would introduce fx risk into the business, which would need to be addressed by additional engagement in financial markets (fx hedging).

In summary, the Associations see the benefits of potential expansion of the use of euro in EU energy markets. However, the Associations believe that this should be encouraged and allowed to increase organically as it has in markets like gas and power rather than be enforced through regulation.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 70 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter @ISDA.

About FIA

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. www.fia.org.

About GFMA Commodities Working Group

The Commodities Working Group of GFMA focuses on regulatory issues specific to banks operating in the financial and physical commodities markets. The CWG's work centres around the creation of a more level regulatory playing field for the commodity markets, advocating consistency and avoiding duplication among legislative measures.

The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit http://www.gfma.org.