The European Association of Corporate Treasurers

Response to the European Commission's public consultation on Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories

13 August 2015

The European Association of Corporate Treasurers (EACT)

The EACT is a grouping of national associations representing treasury and finance professionals in 18 countries of the European Union. We bring together about 13,000 members representing 6,500 groups/companies located in the EU. We comment to the European authorities, national governments, regulators and standard-setters on issues faced by treasury and finance professionals across Europe.

We seek to encourage the profession of treasury, corporate finance and risk management, promoting the value of treasury skills through best practice and education.

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1 – Introduction

We appreciate the opportunity to respond to this consultation.

The post-crisis financial regulation agenda has had a significant impact beyond the financial sector, including on non-financial companies. EMIR is a prime example of this, as the Regulation imposes direct obligations not only for financial institutions but also for non-financial actors engaging in OTC derivatives transactions. The implementation of and compliance with EMIR requirements have been and continue to be a major challenge for NFCs for a variety of reasons. Non-financial counterparties (NFCs) spend a considerable amount of both financial and human resources to ensure compliance with EMIR. They can face severe sanctions in case of non-compliance but are much less resourced and

accustomed to such compliance exercise than their financial counterparties. We believe this is not an efficient use of resources and it distracts treasurers from creating real value to their core business, thereby benefiting the larger EU economy.

We reiterate that NFCs use derivatives for reducing risks of underlying commercial and industrial operations. They do not enter such derivatives for speculative purposes and do not pose systemic risks by their derivative transactions. Furthermore, the use of derivatives for hedging does not simply reduce operational risks for non-financial companies themselves; it also reduces risks for the banks which lend to these companies and hence contributes to the global stability of the financial system.

We believe that the Commission should seize this opportunity to review EMIR and in particular propose amendments to the Regulation that would considerably ease the burden on NFCs, without in our view any way compromising the overall quality of the legal framework and the ability of supervisors to ensure financial stability and to monitor concentration of systemic risks. There are two main amendments that should be implemented. Firstly, single-sided reporting should be adopted so that financial counterparties would have the obligation to report OTC derivative transactions to Trade Repositories (TRs) on behalf of NFCs. Secondly, the requirement for NFCs to report intragroup transaction should be abandoned. These two improvements would also facilitate the work of supervisors by reducing the currently extremely high quantity of data flowing into to Trade Repositories, and would allow better visibility of real systemic risks to supervisors.

2 – Responses to specific questions

Question 1.2: Non-Financial Firms

Article 85(1)(b) states that: " The Commission shall.....assess, in coordination with ESMA and the relevant sectoral authorities, the systemic importance of the transactions of non-financial firms in OTC derivatives and, in particular, the impact of this Regulation on the use of OTC derivatives by non-financial firms;"

Non-financial counterparties are subject to certain requirements of EMIR. However, such counterparties will not be subject to the requirements to centrally clear or to exchange collateral on non-centrally cleared transactions provided that they are not in breach of predefined thresholds, in accordance with Article 10 of EMIR. Further, it is recognised that non-financial counterparties use OTC derivative contracts in order to cover themselves against commercial risks directly linked to their commercial or treasury financing activities. Such contracts are therefore excluded from the calculation of the clearing threshold.

(a) i. Are the clearing thresholds for non-hedging transactions (Article 11, Regulation (EU) No 149/2013) and the corresponding definition of contracts objectively measurable as reducing risks directly relating the commercial activity or treasury financing activity (Article 10, Regulation (EU) No 149/2013) adequately defined to capture those non-financial counterparties that should be deemed as systemically important?

In our experience the definition of a hedge is adequate and there is no need to amend it. NFCs' OTC derivatives transactions are either qualified as hedges under IAS39 or in internal procedures and controls. In case of control by a supervisor, NFCs will be able to demonstrate the hedging character of their transactions, as the vast majority of NFCs do not speculate on derivatives markets. We are also of the opinion that the current clearing thresholds are adequate and should be maintained. We would like to underline the need to make sure that the method for calculation of whether a company is above or below the clearing thresholds is kept simple so that all companies find it easy to monitor compliance.

ii. If your answer to question i. is no, what alternative methodology or thresholds could be considered to ensure that only systemically important non-financial counterparties are captured by higher requirements under EMIR?

We consider that one major change that should be introduced is to limit the obligation for NFC+s to centrally clear transactions only to the asset class where the clearing threshold has been exceeded. At the moment, exceeding the threshold in one asset class triggers clearing obligation and the obligation to exchange margin on transactions not suitable for clearing for all asset classes. In our view the current design is illogical and counterproductive from a broader economic perspective. NFC+s should have an obligation to centrally clear or exchange margin only their non-hedging transactions for the asset class above the clearing threshold but should benefit from the same exceptions as NFC-s

for their hedging transactions. The balance sheets of NFC+s are likely to be significantly impacted by future EMIR margining requirements. Imposing variation margin on hedging transactions below the clearing thresholds will expose NFC+s to daily volatility up to the settlement date of the underlying commercial transaction and will entail higher levels of working capital. This will divert financial resources that could otherwise be invested in the real economy. It should also be noted that NFC+'s will essentially collateralise cash or bank guarantees because as NFCs would typically not hold financial securities. Therefore NFC+s' obligation to centrally clear and to post margin puts an additional layer of credit risk to the banking system as NFCs often have to hold credit lines in banks in order to be able to face margin calls.

2. *(b) Please explain your views on any elements of EMIR that you believe have created unintended consequences for non-financial counterparties? How could these be addressed?*

Non-financial companies have invested and continue to invest considerable funds in the implementation and on-going compliance with EMIR, particularly in reporting. In our view such expenditure is not justified by the overarching objective of EMIR which is to preserve financial stability, as NFCs' OTC derivative transactions are not systemically relevant.

Recently the EACT conducted a survey[1] on the costs of EMIR compliance by NFCs. The survey was responded by 325 companies of different sizes and geographies, and the overwhelming majority of respondents are classified as non-financial counterparties below the clearing threshold (NFC-).

The respondents indicated that nearly all of their OTC derivatives usage was to hedge foreign exchange risk, interest rate risk and/or commodity risk; in a smaller number of cases the respondents also hedge equity and / or credit risk.

In terms of the costs incurred by NFCs due to EMIR requirements, the survey asked the respondents to estimate separately the initial costs of EMIR implementation and the costs of annual maintenance of EMIR compliance. For the initial implementation, roughly 70 per cent of respondents indicated the costs to be up to 50 000 euros, 20 per cent between 50 000 and 200 000 euros and 10 per cent indicated to have spent more than 200 000 euros as implementation costs.

As to the annual compliance costs, approximately half of the respondents stated to have costs of 10 000 euros or below, 35 per cent spent between 10 000 and 50 000 euros and 10 per cent between 50 000 and 200 000 and 5 per cent over 200 000 euros.

These costs are made up of different components, including IT costs, annual maintenance cost of Legal Entity Identifiers (it should be noted that all company subsidiaries must have their own LEIs which significantly raises the costs at group level), audit costs, fees to TRs, bank fees etc. Several respondents have expressed the difficulty in evaluating human

[1] Survey report available at: http://www.eact.eu/docs/EACT-Survey-Report-EMIR-Cost-Compliance-Aug15.pdf

resources costs but consider it to be high.

When looking at these numbers, one should remember that the Treasury department that bears those costs is a small specialised function whose headcount resources are very limited: as low as 1 person for medium size enterprises to around 30 headcount for the largest multinational corporations. When compared with headcount resources, the cost of EMIR is therefore quite significant.

At the level of the European economy the total compliance cost represents a significant investment by companies. However, we very strongly feel that this investment does not contribute to greater financial stability but it drains funds from more productive investment.

We therefore consider that two main changes are needed to the current EMIR regime:

- **One-sided reporting: we see absolutely no added value in reporting the same transaction twice, both by the financial and the non-financial counterparty. The EU should adopt one-sided reporting (as is already done in the US under Dodd Frank) as this would not compromise the supervisors' ability to monitor systemic risk but would greatly ease the burden on companies. NFCs have procedures and audit trails in place to manage risks arising from transacting financial derivatives. In that context, dual-side reporting is redundant as derivatives are traded with financial counterparties.**

- **Exempting non-financials' intra-group transactions from the reporting requirement. Non-financial companies centralise risk management for the purposes of efficiency and cost saving. External derivative transactions (usually of net but sometimes of gross exposures) are often undertaken by a central unit and these are then mirrored appropriately as intra-group transactions with the part of the group where the underlying business risk has arisen. While it significantly increases the reporting burden on companies, reporting the intra-group transactions does not bring any additional value to the supervisor, as the related external trades have already indirectly been reported (twice in fact, due to the dual reporting requirement).**

We believe that these improvements to EMIR would also be helpful to the supervisor as they would decrease the number of reported transactions that bear no systemic significance, and would therefore allow the supervisor to better monitor real systemic risk concentrations within the financial system. One-sided reporting would dramatically reduce the number of entities that are submitting reports to the trade repositories (presumably from hundreds of thousands of companies to maybe a few thousand), which would allow the regulators and trade repositories to focus on a much smaller number of companies to improve data integrity (e.g. with better data validation and compliance checking). This would also mean that any changes that ESMA makes to reporting would impact a much smaller group of companies so may make it easier to make amendments going forward.

A further improvement would be to exclude FX transactions undertaken for commercial purposes by non-financial companies from the scope of EMIR by not classifying them as financial instruments under MiFID as is the case currently in certain Member States. The current proposed definition of an FX derivative needs to be extended to specifically exempt FX instruments used in treasury financing activities. This can be addressed by amending the definition as follows:

"A contract relating to a currency is not a financial instrument if it is a spot contract or a means of payment that must be settled physically otherwise than by reason of a default or other termination event, and is effected to facilitate payment or receipt of payment for goods, services, direct investment or treasury financing activities by a non-financial counterparty (NFC), or by other NFC entities within the group to which the NFC belongs."

3. *(c) Has EMIR impacted the use of, or access to, OTC derivatives by non- financial firms? Please provide evidence or specific examples of observed changes.*

Our members have not reported major changes in the usage of 'plain vanilla' OTC derivatives. EMIR has not greatly influenced big NFCs hedging volumes, but anecdotal evidence suggests that it has for smaller companies: reduced levels of hedging in response to the burdens of EMIR increases business risk.

However, we bring your attention to the BIS statistical data for derivatives which shows that non-financial institutions' vanilla interest rate derivative volumes have dropped materially since 2007 – albeit we must recognise that this may be due to the general low interest rate environment disincentivising any hedging.

Furthermore, EMIR has introduced delays in companies' processes, which in turn further increases risks for NFCs (regulatory or real risk).

Question 1.4: Procyclicality

Article 85(1)(d) states that: " The Commission shall....assess, in cooperation with ESMA and ESRB, the efficiency of margining requirements to limit procyclicality and the need to define additional intervention capacity in this area."

CCPs authorised in the Union must take into account potential procyclical effects when calculating their margin requirements. The specific factors that must be considered to avoid disruptive movements in margin calculations are provided for under Article 41 EMIR and Article 28 of Commission Delegated Regulation (EU) No 153/2013.

(a) i. Are the requirements under Article 41 EMIR and Article 28 Regulation (EU) No 153/2013 adequate to limit procyclical effects on CCPs' financial resources?

No.

ii. If your answer to i. is no, how could they be improved?

As already discussed in our response to Question 1.2 (a) ii, NFC+s should only have the obligation to centrally clear / post margin for their non-hedging transactions above the clearing threshold for the asset class in which they have exceeded the clearing threshold. Requiring central clearing / margining for hedging transactions needlessly mobilises financial resources that could be used elsewhere more productively and efficiently to the benefit of the economy. Abandoning this requirement would naturally also limit the procyclical impact of margining on NFC+s.

As the procyclical nature of margining is recognised, we encourage regulators to reflect on other possible mechanisms to deal with market movements.

(b) i. Is there a need to define additional capacity for authorities to intervene in this area?

Yes

ii. If your answer to i. is yes, what measures for intervention should be considered and why?

The intervention needs to be co-ordinated at G20 level due to interconnectivity of markets.

Clearing Obligations

Under EMIR, OTC derivatives transactions that have been declared subject to a clearing obligation must be cleared centrally through a CCP authorised or recognised in the Union. ESMA has proposed a first set of mandatory clearing obligations for interest rate swaps which are yet to come into force. Counterparties are therefore in the process of preparing to meet the clearing obligation, to the extent that their OTC derivatives contracts are in scope of the requirements.

Question 2.2

(a) i. With respect to access to clearing for counterparties that intend to clear directly or indirectly as clients; are there any unforeseen difficulties that have arisen with respect to establishing client clearing relationships in accordance with EMIR?

ii If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?

(b) i. Are there any other significant ongoing impediments or unintended consequences with respect to preparing to meet clearing obligations generally in accordance with Article 4 of EMIR?

Yes

ii If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?

Whilst we understand that intra-group exemptions are available for clearing and margining requirements, in practice these are likely to be complex and administratively burdensome to obtain for NFC+ corporates. It significantly increases the administrative burden on companies to submit notifications to obtain exemptions for transactions that are not systemically risky. We propose that for NFC+s, intra-group exemptions are automatically granted without having to adhere to the notification process.

Alternatively, as a minimum, a single-sided notification process should be adopted where a centralised risk management function is counterparty to the intra-group derivative transaction to ease the administrative burden for corporates and competent authorities.

Trade reporting

Mandatory reporting of all derivative transactions to trade repositories came into effect in February 2014. The Commission services are interested in understanding the experiences of reporting counterparties and trade repositories, as well as national competent authorities, in implementing these requirements. As noted above, ESMA recently conducted its own consultation on amended versions of these standards. This consultation does therefore not seek any views with respect to the content of either Regulation No. 148/2013 and Regulation No. 1247/2012 nor the proposed amended versions.

Question 2.3

i. *Are there any significant ongoing impediments or unintended consequences with respect to meeting trade reporting obligations in accordance with Article 9 of EMIR?*

   Yes

ii. *If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?*

   Our members' experience demonstrates that there remain significant issues with respect to trade reporting, including the following:

   - **Currently still a high number of unmatched transactions and considerable efforts and resources spent on fixing mismatches. In most cases these mismatches are not due to a real mismatch in data content but rather due to a format difference or incorrect matching rules applied by the trade repository**
   - **The rules and guidance provided by ESMA - despite their efforts - remain unclear and incomplete and subject to interpretation**
   - **The lack of truly standardised reporting format is a major problem that needs to be tackled – currently reporting formats differ depending on the TR, counterparty etc.**
   - **The number of reported fields is much too high and the level of detail is of very little value in our view, e.g. the need to report exact time (including seconds) for execution and confirmation timestamp. We therefore believe that all parties would benefit if the number of reconcilable fields would be decreased and concentrated on fields that contain information necessary for reconciliation. This would in our view limit the number of mismatches – of which a significant proportion is in our experience due to technical mismatches and not to a real mismatch in the reported data. ESMA should furthermore clarify that counterparties to a transaction should not require any specific content on non-mandatory fields; non-financial counterparties are often faced with a mismatch due to financial counterparties expecting a specific content for non-mandatory fields and the required content differs from one financial counterparty to another.**

- **Generally poor readiness levels of all parties, which still reflects on the manner in which reporting is done currently**

Single-sided reporting and excluding NFC intra-group trades from reporting would resolve a large number of these issues.

Risk Mitigation Techniques

Risk mitigation techniques are provided for under Articles 11(1) and 11(2) of EMIR and further defined in Commission Delegated Regulation (EU) No 149/2013. Risk mitigation techniques began entering into force in March 2013 and apply to OTC derivative transactions that are not centrally cleared. They include obligations with respect to transaction confirmation, transaction valuation, portfolio reconciliation, portfolio compression and dispute resolution.

Question 2.4

i. *Are there any significant ongoing impediments or unintended consequences with respect to meeting risk mitigation obligations in accordance with Articles 11(1) and (2) of EMIR?*

   Yes

ii. *If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?*

In our view these obligations are rather burdensome for corporates unless expensive IT solutions are used; spreadsheet-based reconciliations are complex given the constant changes made by banks.

Exchange of Collateral

Article 11(3) of EMIR mandates the bilateral exchange of collateral for OTC derivative contracts that are not centrally cleared. Article 11(15) mandates the ESAs to further define this requirement, including the levels and type of collateral and segregation arrangements required. The ESAs consulted publically on their draft proposals in the summer of 2014.

The ESAs are now in the process of finalising these draft Regulatory Technical Standards. It is therefore recognised that the final requirements are not fully certain at this stage. The Commission services are not seeking comment on the content on the proposed rules published by the ESAs. Nonetheless the Commission services welcome any views from stakeholders on implementation issues experienced to date.

Question 2.5

i. *Are there any significant ongoing impediments or unintended consequences anticipated with respect to meeting obligations to exchange collateral in accordance with Article 11(3) under EMIR?*

   Yes

ii. *If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?*

   The requirements to exchange variation margin (VM), for non-financial counterparties over the clearing threshold (NFC+) does not give corporates sufficient time to raise working capital, implement new systems and processes to adhere to the requirements. This could be addressed by adding a further phase-in for the VM requirements to for NFC+ (currently scheduled to begin margining their bilateral derivatives transactions from 1 March 2017).

Cross-Border Activity in the OTC derivatives markets

OTC derivatives markets are global in nature, with many transactions involving Union counterparties undertaken on a cross-border basis or using third country infrastructures. EMIR provides a framework to enable cross-border activity to continue whilst ensuring, on the one hand, that the objectives of EMIR are safeguarded and on the other hand that duplicative and conflicting requirements are minimised.

Question 2.6

(a) i. With respect to activities involving counterparties established in third country jurisdictions; are there any provisions or definitions within EMIR that pose challenges for EU entities when transacting on a cross-border basis?

Yes

ii. If your answer to (i) is yes, please provide evidence or specific examples. How could these be addressed?

The overall challenge is that the G20 commitments have translated into different legal frameworks with their own specific rules and provisions which leads to companies potentially having to comply with two different sets of regulations, which is both inefficient and costly. Our members are mostly concerned with having to comply both with EMIR and Dodd Frank.

The main solution to this in our view is of course that the EU and the US recognise each others' legal frameworks as being equivalent. It should however be noted that only recognising that both the legal regimes achieve equivalent outcomes is not sufficient from companies' perspective, as they will still have to comply with different rules and processes. Therefore the authorities should also seek to move towards more harmonisation of the detailed rules in place.

More specific difficulties concerning third country jurisdictions include:

- **Some of our members report difficulties in identifying the branches of EU banks that are in the scope of EMIR. Usually local non-EU treasuries are not aware of EMIR, and it is difficult for the central EU treasury to keep up-to-date records of bank counterparties falling within the EMIR scope.**

(b) i. Are there any provisions within EMIR that create a disadvantage for EU counterparties over non-EU entities?

Yes

ii. If your answer to i. is yes, please provide evidence or specific examples. How could these be addressed?

In general EMIR puts a heavier burden on NFCs compared to Dodd-Frank: dual-sided reporting obligation, reporting of intra-group transactions, inclusion in EMIR of all foreign exchange transactions including those that are done for purely commercial purposes.

This could be addressed by removing these obligations from NFCs and excluding FX transactions made for commercial purposes from the scope of the Regulation as discussed in our response to question 1.2.

Additional Stakeholder Feedback

In addition to the questions set out above, the Commission services welcome feedback from stakeholders on any additional issues or unintended consequences that have arisen during the implementation of EMIR which are not covered by those questions.

Question 2.10

i. Are there any significant ongoing impediments or unintended consequences with respect to any requirements or provisions under EMIR and not referenced in the preceding questions that have arisen during implementation?

Yes, we would like to raise the following issues:

- **National supervisors' approaches currently differ greatly in terms of the requirements to fulfill EMIR compliance; therefore NFCs present in several Member States have to comply with fragmented supervisory regimes. NFCs in certain Member States are needlessly subject to more stringent requirements, which creates an uneven playing field. We believe this is an important aspect to tackle as part of the EMIR review and to harmonise national supervisors' approaches and make sure the compliance efforts requested from NFCs are proportionate.**
- **The obligation to back-load transactions concluded before 12 February 2014 (to be reported within three years) should be eliminated as this is burdensome on corporates and we believe brings no value to supervisors.**

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