Werner Langen

European Parliament ECON Committee

13 June 2016

Subject: Our meeting concerning EMIR review

Dear Mr Langen,

First of all we would like to thank you for our meeting on 23 May concerning the review of the European Markets Infrastructure Regulation (EMIR). As a follow-up to our meeting, we would like to summarise our main concerns:

1. The 'hedging exemption' is vital for European non-financial companies, and it should not be removed

We have strong concerns regarding ESMA's recommendation that the clearing thresholds, determining whether a non-financial counterparty is obliged to centrally clear or collateralise bilaterally, should be set irrespective of the hedging or non-hedging nature of the transactions. We would like to highlight that the exemption to centrally clear or to post bilateral margin for hedging transactions serves an important economic purpose, which was acknowledged by the legislator in EMIR and CRD IV. We believe ESMA's analysis has several shortcomings (see our detailed opinion attached), and the recommendations made by ESMA are not appropriate for the following main reasons:

- As ESMA details in the report, NFCs represent only two percent of notional volume of outstanding OTC derivative transactions, which raises doubts as to the potential systemic nature of any individual NFC.
- Hedging transactions represent less systemic risk than non-hedging transactions, because the mark-to-market of hedging transactions will be offset at NFC level by an underlying exposure related to their core activity. Therefore large price moves in an asset class will have little impact on the results of corporate NFCs and are unlikely to cause default of that NFC, let alone cause a financial crisis. Hedging transactions remove financial risk from the real economy.
- Unlike ESMA claims, the risk mitigating nature of transactions is closely monitored and documented by NFCs.
- Imposing initial and variation margin requirements on large NFCs below the clearing threshold - as suggested by ESMA - would force NFCs to mobilise billions of euros[1] for meeting these requirements, thereby reducing funds available for investment in the real economy.

[1] If applied to large NFC-s as presented in ESMA's report, initial margin requirements could amount to between 100 and 200 billion euros depending on NFCs' portfolios, according to our estimations

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2. Reporting obligations of non-financial companies must be reviewed

Non-financial companies have invested and continue to invest considerable financial and human resources in the implementation and on-going compliance with EMIR, particularly in reporting. 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. We support the following changes to the current framework:

- 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 maintaining the dual-sided reporting regime is inefficient, costly and burdensome.

- 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 double reporting and the reporting of transactions that bear no systemic significance, and would therefore allow the supervisor to better monitor real systemic risk concentrations within the financial system.

3. Cross asset class clearing threshold should be eliminated

Currently when an NFC+ exceeds the clearing threshold in one asset class, it is obliged to centrally clear or exchange margin for transactions in 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 for the asset class above the clearing threshold but should benefit from the same exceptions as NFC-s for their other hedging transactions. 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.

4. Timeline of bilateral margin requirements should be aligned with central clearing requirements

The start date of EMIR variation margin requirements is currently set for 2017, which is significantly earlier than the start date of the central clearing obligation (December 2018 for Category 4 counterparties) and the obligation to post initial margin (phased in over 4 years, with NFC+s likely to be impacted in 2020). This means that the obligation to post variation margin is planned to start significantly earlier than the three-year phase-in for NFC+s negotiated by the European Parliament in 2013, which will leave very little time for these companies to prepare. We request that the draft Regulatory Technical Standards on risk mitigation techniques for OTC derivatives not cleared by a central counterparty be amended and the timeline for variation margin aligned with the start of central clearing, as it is illogical to have different start dates for these obligations.

We remain at your disposal for any further clarifications and look forward to a constructive dialogue throughout the EMIR review process.

Yours sincerely,

Jean-Marc Servat
Chair – European Association of Corporate Treasurers