



CORPORATE END-USER COMMENTS ON EC EMIR REVIEW REPORT¹

The above organisations represent over 8,000 companies in Europe. The below comments respond to the Commission's EMIR Review Report published on 23 November 2016

GENERAL COMMENTS

We strongly welcome the Commission's commitment to addressing burdens on non-financial counterparties (NFCs) as part of the EMIR Review. We recognize this must be achieved without impairing post-crisis financial reforms – upholding increased transparency for supervisors and reducing systemic risk.

In this regard **the following key areas** require focus in the EMIR Review:

- **Maintaining the corporate hedging exemption**
- **Alleviating NFCs' annual reporting burdens** of €2.4bn-€4.6bn² by:
 - **Replacing existing duplicative dual-sided reporting with an entity-based model** – transferring responsibility for the timing and content of reporting fully to the financial counterparty in a transaction
 - **Exempting NFCs' intra-group transactions** from the reporting obligation

CALIBRATING CLEARING AND BILATERAL MARGINING REQUIREMENTS

Well intentioned moves to simplify EMIR's corporate hedging exemption should not undermine the fundamental principle that commercial hedging represents responsible risk management.

We welcome the Commission's objective to reduce costs and alleviate disproportionate burdens on NFCs, as well as its recognition of the fact that:

- NFCs have a low level of interconnectedness with the financial system
- EU law already captures the specific and limited cases of systemically relevant financial activity by corporates
- NFCs in Europe currently experience less favourable treatment compared to their international peers

We would also recall that corporates have less-fungible (e.g. equipment) assets than financial counterparties and do not have access to central banks to monetize these assets quickly. Accordingly, **mandatory clearing/margining has the potential to convert long-term credit risk into short-term liquidity risk and ultimately direct insolvency risk for corporate end-users.**

In light of this we are surprised and fundamentally concerned that the EMIR Report is referring to the possibility of imposing clearing and margin requirements based simply on the volume of transactions.

¹ http://ec.europa.eu/finance/financial-markets/docs/derivatives/161123-report_en.pdf

² Industry study based on ISDA survey estimates and available information in July 2016

Such a fundamental change of EMIR core requirements would:

- Contradict the fundamental principle that commercial hedging represents responsible risk-management by corporates; *it would effectively penalize corporates simply for doing more risk-mitigating activity*
- Create arbitrary caps on the level of industrial activity in Europe which can be hedged, *driving corporates to either incur more risk by leaving commercial activities unhedged, or driving hedging operations outside the EU*
- Materially increase uncertainty for corporates operating in Europe
- Run counter to all current Capital Markets Union (CMU) and EMIR Review objectives – by increasing the risk of new costs and burdens for NFCs

We respectfully urge this approach be dropped.

Furthermore we disagree with the Commission statement that NFCs may be finding the hedging exemption difficult to monitor. NFCs already – regardless of their EMIR obligations – have strict risk management procedures in place in order to record and monitor derivatives transactions. NFCs' OTC derivatives transactions are documented either to qualify as hedges under IAS39 or by other internal procedures to link the P&L to the underlying businesses.³

Furthermore, supervisors have already demonstrated their capacity to oversee the current hedging definitions effectively.

By contrast, we would **welcome initiatives to facilitate NFCs' commercial hedging activities** – including an outright exemption for NFCs from clearing and margining under EMIR.

SIMPLIFYING DOUBLE-SIDED REPORTING

Alleviating NFCs' current reporting burdens can only be achieved by a move to entity-based reporting – as practiced across other major global jurisdictions such as US, Canada, Japan and Switzerland. This involves a full transfer of reporting responsibility to the financial counterparty to the transaction. An approach of forced delegation, as under SFTR, would not change the existing burdens for corporate end-users – as ultimate responsibility for the content of reporting would not be explicitly transferred.

EMIR's current dual-sided reporting regime is not delivering its intended objectives of effective supervisory transparency and a proportionate regime for corporate end-users. Instead there are:

- Substantial data quality issues - impairing systemic risk oversight; and
- Significant unforeseen costs for corporate end-users – with ongoing costs for European end-users estimated at €2.4bn to €4.6bn annually

Notwithstanding the **need to proceed with addressing current EMIR data quality issues** (strengthening harmonization of reporting standards and repository trade aggregation guidelines), **in parallel the fundamental issue of the duplicative dual-sided data-reporting for NFCs needs to be addressed.**

To address this, two principles need to be established under EMIR:

- **NFCs should not be legally responsible for reporting to a trade repository when transacting with a financial counterparty; and**
- **Only the counterparty that is responsible for reporting to a trade repository should be the counterparty that is legally responsible for the timing and content of such reports**

³ In a survey conducted in 2015 by the EACT, no respondent identified hedging/non-hedging differentiation as a source of regulatory burden.

EMIR's current delegated-reporting model does not alleviate the reporting burdens for NFCs:

- An NFC that delegates its reporting obligations to a financial counterparty remains legally responsible for the data, leaving corporate end-users with a lack of control over the data reported and the timing of such reporting
- This results in significant legal risks and costs for NFCs
- There is a growing trend of NFCs which had previously delegated their reporting obligations, now moving to self-reporting in order to mitigate these legal risks
- The requirement to report intragroup trades (IGT) in practice prohibits delegation for most companies given the sensitivity of providing internal information to external reporting counterparties

Nor does SFTR's model alleviate the burdens of reporting for corporate end-users:

- **Mandatory delegation of reporting does not change the *status quo*** – EMIR already has a delegated-reporting model (as explained above) and this maintains the legal burden for the content and timing of reporting with the NFC and therefore the ultimate costs
- **The SFTR regime only applies single-sided reporting to SMEs** – this has very limited impact to the vast majority of corporate hedging in Europe and therefore does not lead to meaningful alleviation of the EMIR-reporting cost burden

The EMIR Report proposes exploring whether financial counterparties should report derivatives “on behalf of NFCs”, however this unfortunately also does not change the *status quo* for NFCs:

- **Reporting “on behalf of NFCs” does not shift the ultimate legal responsibility for reporting to the financial counterparty** – like the current delegation model, the legal liability would remain with NFCs
- **No change for NFCs** – because the legal liability for the content of reporting remains with NFCs, the legal and cost burdens would remain with NFCs

Moving to a single-sided entity-based reporting model for NFCs under EMIR⁴ would mean:

- **Sourcing repository data from “golden-source” normal transaction flow** - 100% confirmed between counterparties
 - Replacing the current separate, duplicative reporting process
 - “Golden source” data is part of the normal transaction flow and is subject to EMIR's internal controls and risk mitigation requirements, such as confirmation and portfolio reconciliation
- **No reduction in external market trade data for supervisors** – all current external transactions would be subject to reporting
 - Obligation to agree assignment of responsibility for reporting (e.g., if transaction is between two NFCs) can be included in regulatory requirements for pre-execution controls between counterparties
- **“Automatic check” remains** - difference is the reconciliation of data burden moves from supervisors to counterparties
 - Supervisors would leverage existing portfolio reconciliation requirements between counterparties without having to recreate reconciliations from gross datasets across multiple trade repositories themselves
- **International level playing-field for EU-based NFCs** - major jurisdictions around the world such as US, Canada, Japan and Switzerland already apply an entity-based model for NFCs and, contrary to statements in the non-paper, we are unaware of any stated plans to move away from this model

⁴ For full description see the report “EMIR's data reporting regime - enhancing quality and efficiency” a paper by corporate derivatives end-users, November 2016

It is worth noting that **the principle of single-sided reporting has already been established** in the context of MIFID's RTS2 Art 7 (Paras 5-6)⁵ which establishes post-trade transparency reporting obligations for investment firms concluding transactions outside the rules of a trading venue.

While a single-sided reporting model is the most effective approach, if the SFTR reporting model were pursued, certain modifications and clarifications would be necessary to provide the intended relief for companies:

- Expanding the Art 4.3 exemption for SMEs **to include all NFC-s; and**
- Clarify that the reporting responsibility (whether placed on the financial counterparty as part of the exemption or delegated to a counterparty, under SFTR's Art 4.2) includes legal **responsibility for the timing and content of the data** that is required for reporting to the trade repository.

THE REPORTING OF INTRAGROUP TRANSACTIONS

For **NFCs which manage risks through centralized corporate treasury functions**, intragroup transactions between subsidiaries can regularly lead to **multiples of 3-5 times the number of transactions reported** for every external transaction undertaken.

These intragroup transactions of NFCs do not increase systemic risk, either by creating counterparty credit risk or increasing interconnectedness between financial institutions.

Requiring NFCs to comply with the same reporting requirements for intragroup transactions as those required for external derivatives transactions burdens corporates without any corresponding benefit.

To achieve a meaningful alleviation of EMIR's reporting burdens, a single-sided entity-based reporting model would have to be combined with an intragroup transaction exemption for NFCs

Requiring financial counterparties to report both legs of the NFCs' own internal intragroup transactions would not reduce burdens on NFCs – as it would still require the NFCs to report the full intragroup internal data to the financial counterparty. Additionally, there are inherent confidentiality concerns with reporting any internal data to a financial counterparty.

⁵ http://ec.europa.eu/finance/securities/docs/isd/mifid/rts/160714-rts-2_en.pdf