Deutsches Aktieninstitut

# Proposed exemption for intra-group transactions under EMIR-reporting is justified

Note on the benefits and the risk-neutrality of intra-group transactions within non-financial companies

24 November 2017

# Introduction

We welcome the proposal of the European Commission to exempt intra-group transactions involving at least one non-financial counterparty (NFC) under the reporting regime of the European Derivative Markets Regulation EMIR. Although this exemption is justified, important player like the European Central Bank are concerned and disagree with the European Commission's proposal. These concerns may result from misunderstandings about the practical nature and benefits of intra-group transactions within non-financial groups. Therefore, this note shortly describes the function of intra-group transactions, its key reasons and its insignificance from a risk perspective.

# 1 Intra-group transactions: Function and benefits

Intra-group transactions link the central treasury unit of a NFC with the operative subsidiaries of the group. They are used to deliver centralized treasury and risk management services internally (funding, cash management and payments, financial risk management, investment and insurance management). The internal risk transfer is mirrored by related external trades executed from the central treasury unit with the banking partners through related infrastructures.

One of the main benefits of such an "intra-group-setting" are **netting possibilities** described in the example below. The table shows each exposure of every single operative group entity in USD (both booked invoices and planned future invoices/future cash flows). To avoid losses accruing from the underlying fluctuations of the EUR / USD price these exposures are hedged. The risk of the exposures on legal entity level are mitigated both for long and short positions by internal derivatives provided by the central treasury entity. Externally, only the net position for the whole group is hedged by the central entity with derivatives concluded with financial counterparties. In the example below, the net hedging position for the whole group amounts to 104.0 million USD which is really low compared with the positions that would be otherwise – without a treasury centre – hedged on every entity level (see gross amount of 436 million USD). This results in significant cost savings and a reduction of counterparty risk, which should also be in the interest of the regulators.

| Amounts in million | |
|---|---|
| | |
| **Exposure (in EUR)** | **80.0** |
| ***Exposure (in USD)*** | ***104.0*** |
| | |
| **Legal Entity 1** | **235.8** |
| **Legal Entity 2** | **29.4** |
| **Legal Entity 3** | **-5.5** |
| **Legal Entity 4** | **-1.3** |
| **Legal Entity 5** | **0.0** |
| **Legal Entity 6** | **-3.6** |
| **Legal Entity 7** | **0.3** |
| **Legal Entity 8** | **4.4** |
| **Legal Entity 9** | **0.0** |
| **Legal Entity 10** | **-0.1** |
| **Legal Entity 11** | **0.1** |
| **Legal Entity 12** | **-155.5** |
| | |
| ***Gross amount*** | ***436.0*** |

Further benefits of a centralized treasury unit are the concentration of expertise leading to the execution of external trades by professional staff, a centralized counterparty risk management, increased visibility and central oversight and control of group-wide exposures and risks and increased efficiency by avoiding duplication of efforts. In addition, the risk transfer to a treasury center also allows to shift the counterparty risk to an entity with a lower credit risk.

## 2 Intra-group transactions are risk neutral

It is important to understand that intragroup transactions do not create any new risk at group level as they simply redistribute risks within different parts of the group where the underlying risk originates. With regard to the reporting of derivative transactions, exempting intragroup transactions involving NFCs will not fundamentally decrease the visibility and transparency to supervisors, as the external transaction to which the intragroup transactions are linked will continue to be reported.

This holds true not only for transactions between EU group members, but also for transactions between the treasury center and subsidiaries worldwide. In order to really benefit from the exemption, the definition for intragroup transactions must apply to all transactions within a group worldwide without any restrictions. This includes transactions between the treasury center and financial subsidiaries, which serve operative purposes central treasury cannot offer, like entities providing leasing products for the clients of automotive companies, or accompanying loan facilities in infrastructure projects. From a cost perspective, it does not matter whether all transactions have to be reported or only some. For both cases, most NFCs would have to retain their reporting infrastructure anyway. Even worse, to distinguish between transaction to be reported and those exempted increases the complexity of the reporting system and the administrative burden laid upon the company. Finally, only in case nothing but external transactions has to be reported, this could effectively be delegated to the financial counterparties so that corporates might consider disposing their own reporting infrastructures.

**Therefore, to make the proposal of the European Commission a success story in terms of real cost reliefs intra-group transactions within groups of NFCs must be exempted without any restriction.**

## Contact

Dr. Norbert Kuhn
Head of Corporate Finance
Deutsches Aktieninstitut e.V.
Senckenberganlage 28
60325 Frankfurt am Main
Telefon + 49 69 92915-20
Fax + 49 69 92915-12
kuhn@dai.de
www.dai.de