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European legislator should not remove the reporting exemption for intra-group transactions

Reporting of intra-group transactions is burdensome and does not add any regulatory benefit

Proposal for a Regulation amending Regulations (EU) No 648/2012, (EU) No 575/2013 and (EU) 2017/1131 (EMIR 3.0), 16 February 2023

Intra-group transactions are risk-neutral and did not contribute to recent market distortions

Deutsches Aktieninstitut follows the EMIR legislation very closely expressing the view of non-financial companies using derivatives in their risk management. **Although we strictly oppose the proposal to remove the exemption for the reporting requirements for intra-group transactions** (see further below), we welcome the following improvements in the proposal:

- The exclusion of cleared derivatives from the clearing threshold calculation, which adequately reflects that clearing already mitigates the risk of these instruments;
- To limit the clearing threshold calculation to derivative positions of group members established in the EU;
- The extension of eligible collateral to commercial bank guarantees;
- To improve of transparency and predictability of margin calls;
- To transfer more clearing from third country CCPs and especially UK CCPs, we welcome the proposal to require EU based market participants falling under the clearing obligation to set up an active account with an EU CCP. This would support a market driven migration and ensure that EU market participants are prepared for the end of the temporary equivalence of Tier 2 third country CCPs. An active account requirement would help to reduce any systemic risk potentially resulting from a cliff-edge scenario in which large positions would need to be migrated in a short time period.

Regarding the reporting of intra-group transaction, many companies notified their supervisory authorities to make use of the reporting exemption, have initialised that process or planned to do so. There are many companies already benefiting from the exemption. In terms of legal certainty, we deem it as absolutely inadequate to abandon a rule which was introduced only two years ago. This especially holds true against the background, that the notification process is extremely burdensome for companies having subsidiaries established in many different EU member states. This is because companies are obliged regarding their subsidiaries to notify every single national competent authority separately, which have different processes in place, require the communication in many different languages, forms, templates etc.

In addition, the reasoning behind the removal of the exemption is not comprehensible. The proposal remains unclear on this issue. Firstly, recital 14 mentions "their potential interconnectedness with the rest of the financial system". This assumption has no logic for intra-group transactions with their exclusively internal focus. Groups are connected with the financial system via external derivatives concluded with banks, not through intra-group transactions. As external transactions are reported to trade repositories, supervisory authorities already get a clear picture on the derivative position of non-financial companies and their interconnectedness to the financial system.

Secondly, recital 14 also mentions "recent market developments, in particular strains on energy markets as a result of Russia's unprovoked and unjustified aggression against Ukraine".

We do not see any relation between the current energy crisis, the companies affected thereof and transparency of intra-group transactions. From our understanding, the crisis of certain gas importing energy companies that had to be rescued from insolvency with state aid was triggered by long-term contracts with Russian gas suppliers, but not because of firms' exposure to derivative transactions and consequential margin calls. These group-external supply contracts were matched by obligations to the customers of the respective energy companies. After the delivery of Russian gas was reduced or stopped completely, the companies in question had to buy gas on the market at significantly higher prices in order to meet their obligations. As customer prices initially remained as contractually fixed, the resulting gap caused severe financial problems.

In addition, the energy companies faced increased and frequent margining calls for exchange-traded futures associated with the hedging of their sales transactions for gas and electricity. These margins rose dramatically as the current energy price and volatility level was much above the price level when the futures were concluded. Energy firms experienced consequential material liquidity stress. However, energy firms have employed efficient risk and liquidity management in cleared ex-change and OTC energy markets and they have been able to overcome these and other challenges of the energy crisis. These firms have continued to operate and secure the gas and power supply to consumers despite the challenges of the energy crisis and no market failure caused by increased margin requirements has been observed. It is our understanding that only very few energy firms across the EU have applied for and drawn the credit lines for cash liquidity provided for margining purposes under governmental liquidity programs.

As market participants have to report futures and all other external transactions under EMIR the external risk position should be already known and transparent to the regulatory authorities. Consequently, we do not understand how transparency of intra-group transactions could have contributed to a prevention of firms' liquidity stress.

We agree with the reasoning in recital 14 that "intragroup transactions involving non-financial counterparties represent a relatively small fraction of all OTC derivative transactions and are used primarily for internal hedging within groups. As such, those transactions do not significantly contribute to systemic risk and interconnectedness with the rest of the financial system."

More exactly, intra-group transactions simply redistribute the effects of external hedging transactions entered into by the central group treasury internally and do not increase the overall risk of the group in total. As such, the risks are compensating each other at group level. Accordingly, intra-group transactions are for hedging purposes only, as it makes no sense from an economic perspective to "speculate" with intra-group transactions. Potential losses of an intra-group transaction occurred for a group member are offset by potential gains of the other group member. There is no possibility to make profits/losses in a group as a whole.

Furthermore, given the fact that intra-group transactions (like almost all external transactions as well) are for hedging purposes, it is important to emphasize that there is always an underlying economic business subject to hedges. The effects of the underlying commercial business and the hedging transactions offset each other. Also, centralising treasury activities with intra-group transactions clearly benefit from the financial expertise gathered in a specialised treasury unit of the group or on headquarter level. As e.g. FX risks offset each other group internally to a certain extent, centralising of treasury functions via intra-group transactions might reduce the overall hedging needs by external derivatives.

In summary: intra-group transactions are "risk neutral". The information gathered by the reporting of intra-group transactions is of no conceivable benefit for supervisory purposes - which is why it made sense to abandon it in the first place.

On a further note, the existing exemption provides a level playing field with corporates in the U.S. because their regulator does not require the reporting of intra-group transactions.[1] In addition, according to Art. 4(1)(a) of the Implementing Regulation (EU) No 1348/2014 on data reporting under REMIT, intra-group transactions are to be reported only upon request and on an ad-hoc basis. We wonder why intra-group transactions are not required to be reported under REMIT, which clearly focuses on the reporting of wholesale energy instruments, but should be reported under EMIR in future.

Rather than removing the exemption, we propose some improvements as regards the notification process and the calculation of the clearing thresholds:

1 See the "No-Action Relief for Swaps Between Affiliated Counterparties That Are Neither Swap Dealers Nor Major Swap Participants from Certain Swap Data Reporting Requirements Under Parts 45, 46, and Regulation 50.50(b) of the Commission's Regulations" released by the CFTC in April 2013.

- As mentioned above the notification process as requirement to benefit from the reporting exemption should be designed in a more efficient way than it is today. We assume it as sufficient to notify the national competent authority of the member state, where the headquarter of the group is domiciled. To turn to every national competent authority for every single subsidiary has proven itself as very burdensome, for companies and authorities as well.

- We deem it as not justified that derivatives which hedge a non-hedging derivative, are not allowed to be classified as a hedge. Although the underlying is not an operative business, it is clearly still a hedge economically. Otherwise, one non-hedging derivative has to be counted several times against the thresholds due to this requirement.

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