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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), revised Version 25 May 2023

Introduction

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** and the changes of Article 10 (3), that **would no longer allow for centralised risk management of corporates** under certain circumstances (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 the 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.

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

Regarding the reporting of intra-group transactions, many companies have either notified their supervisory authorities to make use of the reporting exemption, have initialised the process of using the reporting exemption or planned to do so. This demonstrates that there are many companies already benefiting from the exemption.

According to the feedback received from our members we estimate the costs for the removal of the exemption for smaller stock listed companies between EUR 50,000 and 80,000 (one-off) and yearly between 15,000 Euro and 25,000 Euro ongoing. For larger stock listed companies the one-off costs are between EUR 80,000 and 241,000 and the ongoing costs are between EUR 60,000 and 393,000 p.a. This estimate includes costs for the staff in charge of the reporting, the implementation of the respective IT-infrastructure, services of external providers, and the cost which will be incurred for the implementation of the new reporting requirements in April 2024.

In light of these costs and 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 with subsidiaries established in many different EU member states. This is because companies are obliged to notify every single national competent authority separately regarding their subsidiaries. This is cumbersome as each national competent authority has different processes in place and requires 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 is unfounded for intra-group transactions as they have an 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 thereby 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, 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 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 higher than 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 exchange and OTC energy markets and they have been able to overcome these and other challenges presented by the energy crisis. These firms have continued to operate and secure the gas and power supply for 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 already be 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 specifically, 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 as a whole. As such, the risks are offsetting each other at group level. Additionally, 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 within the group 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:

- As mentioned above the notification process as a 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

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.

economically. Otherwise, one non-hedging derivative has to be counted several times against the thresholds due to this requirement.

2 Non-financial companies should be allowed to continue centralised risk management

Article 10 (3) EMIR states that only those derivatives should be counted against the clearing thresholds, which are **not** reducing the risk of the non-financial company or **of that group**. As the EU Commission's proposal deletes the reference to the group in Article 10 (3), we fear that this amendment would no longer allow for centralised risk management of corporates under certain circumstances. This holds especially true for non-financial companies with centralised treasury functions, which hedge operative businesses on behalf of their group entities (as those are transactions that do not hedge risks of that treasury entity).

We urge to reinstate the possibility for European corporates to centrally hedge the risks relating to the commercial and treasury financing activities (in particular foreign exchange (FX), interest rate (IR) and commodities) of their entire corporate group. Otherwise, centralised treasury units bear the risk to become clearing obliged if they hedge risks on behalf of their group entities and hence lack the respective underlying of the derivative. Alternatively, every group entity has to hedge their risks for themselves, which would contradict the advantages of centralised risk management in groups described above (especially the financial expertise on the centralised unit and the decreased hedging needs due to netting effects).

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