

ESMA Review Non Equity Transparency: Reflect Specifics of Derivatives used by Non-financial Companies

Preserve Waivers for Hedging-Instruments not
traded on Secondary Markets

Answers to selected Questions

Q5. Would you support turning the hedging exemption into a limited negotiated trade waiver? If so, would you support Option 1 or Option 2? If not, please explain why.

No, as the hedging exemption is of importance for non-financial companies not only using commodity derivatives, we would like to re-iterate its justification. Besides, it is worth to note that many OTC-derivatives, i.e. those instruments largely used for hedging purposes, are not regarded as equivalent to instruments traded on a trading venue (TOTV). As these instruments are not in the scope of the transparency requirements this might explain why almost only commodity derivatives benefit from the exemption so far. The introduction of a broader concept of TOTV as discussed by ESMA will change this situation. More instruments besides commodity derivatives will benefit from the exemption.

In general, the exemption is justified as it acknowledges that OTC derivatives used by non-financial companies for hedging purposes – including contracts executed on MTFs or OTFs – are different from securities and in particular shares: These derivatives are not fully fungible and standardized transactions and are requested individually by customers when required. Like loan contracts, leasing contracts, saving account contracts etc. these derivative transactions are contracts bilaterally agreed between clients and banks. Trading of these individual derivatives in question on secondary markets effectively does never take place.

These transactions do not involve any type of investor involved who needs special protection or who benefits from transparency. On the contrary, especially for larger transactions or transactions referring to an illiquid underlying it is very likely that transparency distorts the price formation process to the detriment of the non-financial company requesting the derivative. If an order is split up into smaller parts (which is a common practice for larger and/or illiquid transactions), orders executed at a later stage will become remarkably more expensive. The reason for this is that it is unlikely that various companies demand an identical transaction at the same time. The supply side can therefore conclude that the split orders are requested from the same end-user, and can bet against him. As a result, prices will increase which makes risk management with the derivatives in question more expensive.

We therefore urge ESMA to leave the exemption as it is. For reasons of coherence, the exemption should also be inserted in Art. 21 MiFIR regarding the post-trade transparency for non-equity instruments.

If the legislator opts for the deletion of the exemption and instead inserts a negotiated trade waiver the particularities of derivatives used by non-financial companies described above must be adequately reflected. In that case, the waiver should apply to all derivative transactions (Option 1) instead of a limitation for commodity derivatives, especially for the case of an extended scope of TOTV.

Q16. Do you agree with ESMA’s above assessment? If not, please explain.

Besides the “hedging-exemption” (see our answer to question Q5) TOTV ensures that only actively traded instruments are in the scope of the transparency regime. With regard to derivatives used by non-financial companies the existing TOTV is well-balanced. As stated above (see our answer to question 5) these instruments are bilaterally agreed between the company and the financial counterparty. They are not traded on secondary markets involving investors benefitting from the market transparency. Correctly, these instruments are not in the scope of the transparency requirements. We also think that the “same reference data details” (volume, maturity, ISIN etc.) are well calibrated and help to identify those instruments which are not equivalent to those traded on a trading venue. Lastly, we refer to the fact that all derivative transactions, TOTV or not, are already being reported under EMIR so there is no detriment to market transparency in our view.

Q18. Which of the three options proposed, would you recommend (Option 1, Option 2 or Option 3)? In case you recommend an alternative way forward, please explain.

We re-iterate our statement that pre- and post-trade transparency is only useful for instruments traded on secondary markets. This is not the case for hedging derivatives used by non-financial companies. Therefore, irrespective of the options proposed above it should be clarified that these instruments are out of the transparency scope.

For these instruments, as mentioned in our answer to Q16 we deem the current TOTV justified and well-calibrated. In this regard, there is no need for option 2 or option 3. Nevertheless, if ESMA comes to the conclusion that option 2 or option 3 should be introduced, equivalence criteria should properly reflect the specifics of hedging instruments used by non-financial companies.

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