Deutsches Aktieninstitut

EMIR Review of the European Commission – Assessment of Deutsches Aktieninstitut

Comment on the European Commission's Proposal for a Regulation amending Regulation (EU) No 648/2012 (EMIR), 8 June 2017

Introduction

On 4th of May the European Commission released its proposal to amend the European Market Infrastructure Regulation (EMIR). Deutsches Aktieninstitut followed the review process of EMIR very closely from the perspective of Non-Financial Companies ("NFC") using derivatives in their risk management. Please find below our assessment of the European Commission's proposals.

1.1 Hedging Definition

EMIR exempts NFCs from clearing and margining requirements if they do not cross the clearing thresholds. Derivatives used for the mitigation of risks stemming from the operative businesses (e.g. to hedge against currency, interest rates or commodity price fluctuations) are not counted against the thresholds. By this, the legislator acknowledges that derivatives are of utmost importance for the risk management of NFCs. Hedging with derivatives stabilizes cash flows thus enhancing creditworthiness and long-term ratings of NFCs. The proposal of the European Commission confirms the strategic importance of risk mitigating derivatives and retains the hedging exemption under Art. 10(3) EMIR. We welcome that the European Commission does not intend any changes on this central issue and strongly recommend preserving this exemption in the forthcoming legislative procedure.

1.2 Reporting Issues for NFCs

We welcome the proposals of the European Commission regarding the reporting of OTC and exchange traded derivatives under EMIR in general. However, some questions should be clarified in order to effectively reduce the reporting burden for NFCs, as intended by the European Commission.

- **Categorization of NFCs for reporting purposes**

  We understand the proposal of the single sided reporting regime as a relief for all NFCs that did not cross the clearing thresholds (NFC-). In this regard, the term "small NFC (i.e. not subject to the clearing obligation)" is confusing (p. 10 and recital 14), as the majority of corporates fulfils this prerequisite (using OTC-derivatives to hedge operative risks), irrespective of their size. Therefore, forthcoming EMIR should unambiguously state that any NFC- (corporates exempted from the clearing obligation) can benefit from the exemption.

- **Reporting responsibilities**

The proposal that the financial counterparty reports on behalf of a NFC- would reduce the bureaucratic burden for many companies significantly. As a prerequisite, intragroup transactions have to be exempted, as proposed by the European Commission. Otherwise, most NFCs would have to retain the respective reporting infrastructure anyway. To benefit from the delegation really, liability for the reporting should be restricted to the financial counterparty. In this regard, the proposed language ("on behalf", "ensuring the accuracy", see the amendment of Art. 9(1a)) may not be strong enough. So far, it is also unclear how transactions with third country banks should be dealt with, as these banks are not subject to the European rules and hence likely to refuse the delegation. While this currently would already concern many standard business partners of NFCs, this group will probably grow further by the forthcoming Brexit. A solution for this problem could be a registration possibility for third country banks comparable to Dodd-Frank (registration as Swap Dealer or Major Swap Participant), applying for the reporting regime only and not for other activities.

As many detail problems wait for a clarification to make the proposed reporting regime a success story, we strongly recommend that NFC- should have the chance to assess their situation individually and hence the option to stick to the current dual sided system, having the required infrastructure in place anyway.

- **Postponing the entry into force of new reporting standards**

The amendment of the European Commission's delegated act on the minimum details of the data to be reported to trade repositories is applicable from 1 November 2017. NFCs currently spend significant financial and personal resources for the implementation of the new rules. Regarding the proposed new reporting regime, where the financial counterparty reports on behalf of the NFC-, the start of the new reporting standards should be aligned with the entry into force of the upcoming EMIR amendments. Otherwise, the resources spent until November for the implementation of the new rules are misallocated when the financial counterparty reports on behalf of the NFC- after the entry into force of the amended EMIR.

- **Exemption for intragroup transactions concluded by NFCs**

  The proposal is fully justified as intragroup transactions solely redistribute risks within the group (usually between treasury and operative entities) but do not create new risks or increase the risk on a group level basis. Potential losses of one group member are potential gains of another. In fact, intragroup transactions within NFCs are risk neutral. There is no benefit from a supervisory perspective to collect information of the extent of intragroup transactions. To provide this data is very burdensome for NFCs. Nevertheless, in order to benefit from the exemption the definition intragroup transactions must apply to all transactions within a group worldwide without any restrictions. In this regard, Art. 3 para. 1 EMIR, dealing with the definition of intragroup transactions, should be reviewed.

- **Reporting of historic data ("backloading") removed**

  We share the assessment of the European Commission that the back-loading requirement, i.e. transaction concluded before the reporting requirements entered into force, is difficult to implement. Furthermore, data of historic transactions, i.e. transactions that are no longer out-standing on the start of the reporting requirements, are of no information value for supervisory purposes.

1.3 Clearing obligation

The proposal to reduce the "cliff effect" by subjecting only the asset classes to clearing which have breached the clearing thresholds will not be much relief in practice, given that all derivatives would still be subject to margining requirements (see recital 7 on p. 19). Therefore, the "cliff effect" effectively remains, as bilateral collateralisation will affect NFC's liquidity significantly. Clearing fees (i.e. the proposal's effective savings) are only a minor point in this calculation. A com-parable question comes up with regard to the deletion of the "frontloading" requirement (see recital 8 on p. 19 and Art. 4a on p. 26). While we welcome the idea to "ringfence" transactions already concluded when the clearing thresholds are crossed, the cost savings of this step would again be very limited for NFCs if the legacy transactions would still require bilateral collateralization. Therefore, it is necessary to bring both requirements – for clearing and bilateral collateralisation – in line by stating that the scheduled reliefs for the clearing obligation include the omittance of bilateral collateral exchanges.

NFCs crossing the clearing thresholds have to clear respective derivatives after a transitional period of 4 months. This transitional period should also apply for the very time-consuming negotiations of bilateral collateralisation agreements.

1.4 Counterparty Classifications

The proposal widens the definitions for Financial Counterparties (FC) to include securitisation special purposes entities as defined in Article 4(1)(66) of the CRR (SSPEs). Currently SPEs (e.g. for automotive leasing receivables) are classified as NFC. If reclassified as FC the SPVs will be required to post collateral in respect to their derivate contracts, even if they are used for hedging purposes only. Furthermore, the relevant vehicles are highly unlikely to have access to eligible collateral and will be restricted by the terms of the transaction documents in their activities. This would be counterproductive to the European Commission's Capital Markets Union efforts to revive the securitisation markets and hence should be reversed.

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