The European Association of Corporate Treasurers

Comments in response to the Consultation on Standardization and exchange trading of OTC derivatives (CESR/10-610, issued by CESR on 19 July 2010)

The European Association of Corporate Treasurers (EACT)

The EACT is a grouping of national associations representing treasury and finance professionals in 17 countries of the European Union. We bring together about 8,100 members representing 4,600 groups/companies located in the EU. We comment to the European authorities, national governments, regulators and standard-setters on issues faced by treasury and finance professionals across Europe. We seek to encourage the profession of treasury, corporate finance and risk management, promoting the value of treasury skills through best practice and education.

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Summary and general comments

The EACT supports CESR's view that greater standardization of OTC derivatives contracts can deliver efficiency benefits to the market. In particular, we agree that use of electronic confirmation systems is one of the processes that can potentially deliver benefits to some parts of the market. We also support the objective of further exploring what measures could be taken to foster a higher degree of standardization. However, we do not suggest to focus only on certain elements of standardization or particular asset classes but to work jointly on both.

For their core activity of mitigating financial risk in their businesses, corporate treasurers must have access to non-standardized derivatives (i.e. customised derivatives). This is important both for the accuracy of the hedge (eliminating 'basis risk' through the closeness with which the hedge matches the underlying risk in the business) and to support hedge accounting under IFRS.

The EACT agrees that trading on organised markets could deliver a number of benefits such as a higher level of transparency, enhanced liquidity, efficiency and risk reduction, as well as providing easier access for market participants. However, the EACT sees a number of limitations or constraints on exchange trading of derivatives: corporate treasurers need and benefit from the scope for innovation in terms of OTC derivative products and customised financial instruments, since such innovation further strengthens the ability of the treasury management process to reduce financial risk and improve financial reporting. The greater use of electronic trade confirmations is supported by corporate treasurers. Nevertheless, for cost and other reasons adoption should not be mandatory for non-financial companies, in contrast with its imposition on financial institutions, banks, brokers and traders.

Responses to consultation questions

Please note that the EACT's responses are limited to the questions of direct relevance to corporates.

Q.1 Do you agree with CESR's assessment of the degree of standardization of OTC derivatives? Is there any other element that CESR should take into account?

Yes.

Q.2 Do you agree with the benefits and limitations of standardization?

Yes.

Q.3 Do you agree that greater standardization is desirable? What should be the goal of standardization?

We agree that greater standardization is desirable, provided that the importance of non-standardized instruments is fully accepted. These meet the core needs of corporates for risk mitigation through hedging. We suggest that the goal of standardization should be to improve transparency on some products and asset classes such as CDSs. We are strongly opposed to any move to full standardization for all derivatives. Such an approach would materially penalise corporates in their risk management and their ability to achieve hedge accounting under IFRS. As a direct consequence there would be increased economic and financial reporting volatility.

The EACT accepts that a certain degree of standardization for some predefined financial instruments could deliver efficiency benefits to the market. It also agrees that traditionally innovations come first in OTC transactions, which are developed and traded before reaching maturity and potentially then being negotiated through exchange trading.

Bilateral electronic confirmation is relevant and should be recommended or encouraged but not imposed in any sense for non-financial companies (in contrast to being mandatory for entities within the financial sector, which the EACT supports). These companies do not necessarily have a sufficient degree of automation and IT capabilities to electronically confirm all trades.

The EACT recognizes that exchange-trading platforms require standardization and enable automation and electronic confirmation. However for the reasons already outlined above corporates need the flexibility of non-standardized products, which by definition will not be able to be exchange-traded.

Q.5 Are there any obstacles to standardization that could be removed by regulatory action? Please elaborate.

The IFRS approach to fair value accounting relies on an arbitrary test of effectiveness in determining treatment. This accounting standard therefore acts as an obstacle to standardization by making it unattractive – for those companies that wish to achieve hedge accounting – to use anything other than bespoke contracts. The EACT would prefer that the IFRS approach concentrated only on the economic effectiveness of hedging contracts; such an approach, if adopted in future IFRS, would encourage greater use of standardized products when these did not jeopardize fair value accounting.

Q.7 CESR is exploring recommending to the European Commission the mandatory use of electronic confirmation systems. What are the one-off and ongoing costs of such a proposal? Please quantify your cost estimate.

The EACT is not in a position to estimate any of the costs associated with CESR's proposal.

Q.10 In your view, for which sectors of the market will increased transparency associated with exchange trading increase liquidity and for which sectors will it decrease liquidity?

For interbank and broker dealing, exchange trading will likely increase transparency and liquidity. For non-financial companies, there will not be an increase in liquidity. Exchange trading for some limited standardized products could offer some benefits that address the concerns raised by the financial crisis and that fulfill the objectives determined by G20 (such as improved transparency, greater market integrity, lower risk).

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