Position of DAI, BDI and VDT on the ESMA's Consultation Paper "Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories"

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Deutsches Aktieninstitut (DAI)[1], Bundesverband der Deutschen Industrie (BDI)[2] and Verband Deutscher Treasurer (VDT)[3] welcome the opportunity to comment on the ESMA's consultation paper on "Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories". Our answers represent the view of non-financial companies using derivatives almost exclusively to mitigate risks related to their commercial or treasury finance activities.

Although we appreciate the progress made since the first consultation round in spring, we nevertheless think that there is still work to be done in order to adequately reflect the existing risk management structures of non-financial companies in the technical standards. Furthermore, to avoid regulatory arbitrage and to establish a level playing field on the global derivative market we advocate to align the EU rules with the rules already adopted by the U.S. CFTC. This applies especially for the following:

- The definition for derivatives qualifying as "risk-mitigating" according to Art. 10 EMIR (resp. Art. 1 NFC of the proposed standards) should be extensive enough to include wide-spread risk management strategies established in non-financial companies of all size. This should comprise macro and portfolio hedging as well as the common practice of closing derivative positions by another derivative;

- ESMA should acknowledge that the definition of risk-mitigating derivatives and the clearing threshold are two sides of the same coin. The clearing threshold should be regarded as a buffer for those "cases of doubt" where a derivative is risk-mitigating from an economic point of view but is not formally qualifying as such according to the standards. Thus, some adjustments to the determination of the clearing threshold are necessary, e.g. to limit the clearing obligation to the respective class of derivatives where the clearing threshold was exceeded, to refer to the net notional amount, to acknowledge netting agreements and collateral already posted;

- Elaborating internationally consistent rules for the reporting requirements in particular regarding the globally consistent identification of trades seems a

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2 Bundesverband der Deutschen Industrie e.V. (BDI, www.bdi.eu) is the umbrella organisation of German industry and industry-related service providers. It represents 38 industrial sector federations and has 15 regional offices in the German Länder. BDI speaks for more than 100,000 private enterprises – 98 % small and medium sized – employing around 8 million people. Membership is voluntary.

3 Verband Deutscher Treasurer e.V. (VDT, www.vdtev.de) is the official German association of Corporate Treasurers representing more than 950 treasury professionals from 450 companies.

very challenging task for the supervisory authorities. By now we are still missing feasible solutions. European interim solutions would even increase the already very high costs of the reporting requirements especially for non-financial companies and should be avoided. Therefore, we ask ESMA to defer the proposed start date of the reporting requirement to 1 January 2014 at the earliest. Also, once a trade repository has been registered, a period of only 60 days seems not feasible and should be extended to 6 months.

- It is not acceptable to oblige market participants to report the market value of their derivatives on a daily basis. This newly introduced proposal contradicts the legal language of EMIR and neglects the fact that non-financial companies are not required to mark-to-market their derivatives on a daily basis. This requirement is also inconsistent with the approach followed by ESMA in order to define the clearing threshold. In this context ESMA argues against the market value as a calculation method with the explanation that it is not reasonable for companies to implement such a complex method.

- As non-financial companies use derivatives primarily for risk-mitigating purposes the risk-mitigating techniques should be proportionate. This applies especially for the proposed confirmation period which should be extended from two to four days. We also think that the duty to reconcile the portfolio at least once a month would be very costly without having any useful effect.

Please find our concerns, which also relate inter alia to the group exemption and the collateral requirements, in detail below. We would appreciate if ESMA could take our proposals into account.

I) Non-financial counterparties

a) Criteria for establishing which OTC-derivative contracts are objectively reducing risks (Annex II, Art. 1 NFC)

We generally welcome the clarification that an accounting treatment pursuant to IFRS is only *one* alternative for a derivative to be classified as risk-mitigating according to Art. 10 EMIR. Nevertheless, in order to provide legal certainty Art. 1 NFC of the proposed technical standards should be clarified as suggested below to better reflect the common risk-mitigating practices of non-financial companies.

1) Recognition of wide-spread risk-mitigating strategies

According to Rec. 30 EMIR due “consideration should be given to whether an OTC derivative contract is economically appropriate for the reduction of risks in the conduct and management of a non-financial counterparty”. Therefore, the technical standards should acknowledge risk-mitigating strategies like macro, portfolio or proxy hedging which are wide-spread among large and midsized German companies. Macro hedging, which is e.g. established in company groups with a centralised risk-management providing treasury services for the legal entities of the whole group, is a cost efficient way to risk-mitigate the *net* position of the whole group instead of hedging the positions of each single legal entity. It thus also reduces counterparty risk. Unlike the so called micro hedging, these risk-mitigating strategies have in common that one derivative in question cannot be allocated to one respective underlying business. ***In order to better understand the functioning of macro hedging please refer to our example described in the annex to this position paper.***

So far ESMA explicitly considers proxy hedging as risk-mitigating in accordance with the proposed standards. To gain legal certainty it should be clarified that derivatives used in a macro or portfolio hedging strategy also comply with the requirement laid down in Art. 1 NFC (p. 72). This would be in line with the ongoing discussion in the IASB to provide a much more extended approach regarding macro hedging in the forthcoming IFRS 9 which could be applied also by non-financial companies. Furthermore, e.g. German accounting rules (so called “Bewertungseinheiten”) already recognize these strategies as risk-mitigating. If not, many companies would risk that at least a part of their derivatives is not qualifying as risk-mitigating although, from an economic point of view, they are. As a consequence these derivatives may fall into the category “speculative”, “trading” or “investing” and may have to be included in the calculation of the clearing threshold. Abandoning a centralised risk management approach framed by appropriate guidelines and equipped with specialised staff members would be no alternative as this is a prerequisite for an efficient risk-mitigating strategy of non-financial groups. This efficiency must be preserved. Otherwise, more transactions would be required to cover individual exposures which would result in a significant increase in cost and administrative efforts.

Therefore, we propose to amend the wording of Art. 1 NFC as follows:

“For the purpose of Article 10(3) of Regulation (EU) N0 X/2012 [EMIR], an OTC derivative contract is objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group, when, whether by itself or in combination with other derivative contracts, and whether directly or through closely correlated instruments ***or based on customary risk-mitigating management principles***, it meets one of the following conditions: […]”

2) Consider specifics of the risk-mitigating strategy

ESMA considers that derivatives which are used for “speculation”, “trading” or “investing” should not qualify as risk-mitigating. We fear a too wide interpretation of these terms. As an example, “trading” may easily refer to closing any transaction irrespective of its background. As the term “investing” is not much clearer, we suggest to delete references to “trading” and “investing” for that purpose, or replace all three terms by a more precise “speculative trading”, which should cover ESMA’s primary concern.

In this context please refer to the following case studies where the underlying business operation is not evolving according to plans (***another example can be found in the annex of this position paper***):

It is in the nature of the risk management of non-financial companies that a derivative contract which was entered in a risk-mitigating purpose might unexpectedly become superfluous before its expiry. An airline company, e.g., anticipates a given future need of fuel and mitigates the risk related to price fluctuations to a certain extent. Later on, however, passenger figures evolve less strong than expected and the amount of fuel hedged proves too high.

The same applies for a company taking part in a large tender in a foreign currency. As such a tender may take some time, the company may decide to buy a currency option (for example EUR Call / USD Put) from a bank with a tenor similar to that of the tender. In case the customer makes his choice already prior to the end of the bidding period and not in favour of the company, then the commercial underlying ceases to exist.

Both examples have in common that the derivatives are forthwith lacking the underlying risk for which they were originally concluded. Closing this position can, of course, be achieved by immediately selling the derivative back to the bank. However, it is also clear that the bank will not bid competitively for that repurchase so that a loss for the company is almost inevitable. Therefore, the company may also eliminate the risk related to that "open" derivative position by entering into a reversing derivative transaction with another bank with identical parameters and expiry date. As a result the company then has two derivative transactions on its books. Both are closed positions in the sense that they are neutralizing each other, but are lacking a formal relation to the commercial or treasury finance activity.

These examples deal with risk-mitigating strategies that are established to adjust to unexpected events in accordance with the internal risk management guidelines. This flexibility should be preserved under the upcoming technical standards and should not be confused with "trading," "investment" and "speculation", but should be treated as risk-mitigating. Therefore, we propose a clarification which takes reference to the rules already adopted by the CFTC:

- The CFTC concludes that "whether a position hedges or mitigates commercial risk should be determined by the facts and circumstances at the time the swap is entered into, and should take into account the entity's overall hedging and risk mitigation strategy."[4] Referring to the overall risk management is important because it is up to the non-financial company to demonstrate in a reasonable manner that the adjustment of the derivative portfolio is not for the purpose of "speculation" etc., but is in line with its risk management guidelines (which should be comprehensible for third parties, in particular for the auditor or the supervisory authority);

- ESMA should also clarify that derivatives, which are not directly used to mitigate risks related to the commercial or treasury finance activities, but which are used to reduce risks of another derivative, which itself is risk-mitigating, should be covered by the definition. This would be in line with a similar rule set by the CFTC.[5]

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4 See CFTC / SEC: Further definition of "Swap Dealer", "Security-based Swap Dealer", "Major Swap Participant", "Major Securities-based Swap Participant" and "Eligible Contract Participant", p. 295.

5 See CFTC / SEC, l.c., p. 588: "Such position is […] not held to hedge or mitigate the risk of another swap or security-based swap position, unless that other position itself is held for the purpose of hedging or mitigating commercial risk as defined by this rule or § 240.3a67-4 of this title."

3) All risks should be considered

We propose to provide coherence between Art. 1 NFC lit. a and lit. b. as the former is the more comprehensive approach and covers risks related to fluctuations in commodity prices, share prices and risks related to e.g. trade receivables. Therefore, these risks should be mentioned in lit. b and the wording should be amended as follows: “[…] resulting from fluctuations of interest rates, inflation rates, ***commodity and share prices*** or foreign exchange rates ***as well as from the risk that a counterparty defaults***”. This supplement would also be in line with the definition of the clearing threshold (Art. 2 NFC) which considers five different asset categories and therefore exactly reflects the risks which should be added as mentioned above: Credit default risk (CDS), share price risk (equity derivatives), fluctuations in interest rates, exchange rates and commodity prices.

4) Clarification of the term “ordinary course of business”

Companies use derivatives not only in standard cases of daily operations, but also in those that occur less frequently, but are nevertheless part of ordinary treasury business. Examples are convertible bonds, repurchases of own shares, the increase of share capital or employee stock ownership plans (ESOP) where derivatives are sometimes applied to reduce costs and to enhance planning reliability. It should be clarified that such activities also count as “ordinary course of business” as mentioned in lit. a.

5) National accounting standards should also be acknowledged

The definition in Art. 1 NFC para. 1 lit. c should not exclusively refer to hedge accounting according to IFRS but also acknowledge national hedge accounting rules, as especially smaller companies are not required to apply IFRS. This would be consistent with the statement of ESMA that national GAAP are deemed to comply with the definition set out in Art. 1 NFC para. 1 lit. a and b (see p. 15). To gain legal certainty we suggest clarifying the equivalence of national accounting rules and IFRS in the technical standards.

6) Role of the external auditor

ESMA should also acknowledge the role of an external auditor monitoring the prudent application of the hedging definition. This would also help to keep the enforcement process as lean as possible – for the benefit of supervisory authorities, corporates and their stakeholders. The task to examine which derivatives are applied by non-financial companies to mitigate commercial or treasury risks (e.g. as a negative statement) should be executed by the auditor. Reference could also be made to the overall risk management strategy of the non-financial counterparty which would reflect the requirement laid down in recital 16a EMIR ([…] „due account should be taken of that non-financial counterparty’s overall hedging and risk mitigation strategy“.) For instance, German companies are already obliged by the national commercial code to disclose details of their risk management strategy including methods to mitigate risks stemming from their business activities.

b) Clearing Threshold (Annex II, Art. 2 NFC)

Although the clearing thresholds proposed by ESMA are more comprehensive as previously discussed we want to reiterate our concerns already brought forward in our comment on the discussion paper:

- As outlined above, there are still many uncertainties about which derivatives will qualify as risk-mitigating according to Art. 10 EMIR (resp. Art. 1 NFC). Even if these problems were solved in a manner that would appropriately reflect the risk management practice of non-financial companies we think that several "cases of doubt" will remain. Therefore, the thresholds should be primarily regarded as a buffer for derivatives which are risk-mitigating from an economic perspective, but might not formally qualify as "risk-mitigating" according to the technical standards. Our amendments refer in particular to the wording of EMIR which should be mirrored by ESMA;

- To ensure a level playing field on the global derivative market, we prefer aligning the EMIR clearing threshold with the thresholds defined by the U.S. CFTC for the "Major Swap Participant" (MSP), especially the calculation of the "potential outward exposure" which we would regard as equivalent to the approach taken by ESMA. These U.S. rules inter alia refer to the notional value and grant comparable thresholds. Nevertheless, there are some crucial differences between the two approaches which should be considered by ESMA as the approach of the CFTC more appropriately reflects the risk management strategies of non-financial companies.

Therefore, ESMA should consider the following issues as they are of severe importance for non-financial companies:

1) Breach in one asset class should trigger the clearing obligation for that asset class only

We do not share ESMA's view that the clearing obligation should apply to all OTC derivatives after the clearing threshold was breached only in one asset category. According to the rules of the CFTC this consequence should be limited to the respective asset class. A clearing obligation for the whole derivative portfolio – even when only one threshold has been exceeded – would be very burdensome for non-financial companies. Therefore, we strongly advocate to follow the approach taken by the CFTC and to provide the possibility to limit the clearing obligation for derivatives to the asset class or classes where the threshold was exceeded.[6]

This approach is also stipulated by EMIR in Rec. 31 that the "values of the clearing thresholds […] are determined taking into account the ***systemic relevance*** of the sum of the net positions and exposures […]". It should be acknowledged by ESMA that only those classes of derivatives where the clearing threshold is breached could

6 See CFTC / SEC, l.c., p. 574: "A person that is a major swap participant shall be deemed to be a major swap participant with respect to each swap it enters into, regardless of the category of the swap or the person's activities in connection with the swap. ***However, if a person makes an application to limit its designation as a major swap participant to specified categories of swaps, the Commission shall determine whether the person's designation as a major swap participant shall be so limited.***"

be considered as systemic relevant. Furthermore, Art. 10 EMIR refers to consequences of a breach of “the” threshold, not “one of the” thresholds.

2) Only the net notional amount should be taken into account

Since under certain circumstances it is necessary to economically close or adopt hedging positions (please refer to the examples described above) it is crucial that ESMA limits the positions relevant for the calculation of the clearing threshold to the “net notional amount per class of OTC derivatives”. This would appropriately reflect Art. 10 para. 4 lit. b and Rec. 31 EMIR which state that the setting of the clearing threshold should take the “sum of ***net*** positions and exposures” into account.

3) Netting agreements and collateral already posted should be acknowledged

Art. 10 para. 4 lit. b and Rec. 31 EMIR should also cover netting agreements. In addition, Rec. 30 EMIR states that risk mitigation methods already applied by the non-financial counterparties should be considered in the calculation of the clearing threshold (“[…] recognise the methods of risk mitigation used by non-financial counterparties”). ***Hence, the derivative exposure relevant for the calculation of the clearing threshold should be adjusted for bilateral netting agreements and already posted collateral – the calculation of the clearing threshold should exclusively refer to the netted, uncollateralised exposure.***

This would be coherent with the rules of the CFTC which acknowledge netting agreements. Furthermore, according to the CFTC collateralised derivatives are completely exempted from the threshold calculation under certain circumstances. Other derivatives which are subject to daily mark-to-mark margining or are cleared by a CCP are assigned a multiplier of 0.2 resp. 0.1 (NB: after applying the risk multiplier mentioned below).[7]

4) Separate commodity derivatives from “other” derivatives

The market has developed a variety of hybrid products combining elements of different asset classes, e.g. cross currency interest rate swaps, which are very useful from a treasury perspective as they can reduce the numbers of transactions necessary for tailored risk-mitigating needs. Nevertheless, it remains unclear in which category these instruments are captured. If these derivatives have to be counted together with commodity derivatives, the threshold amount for this category should be higher than proposed. Otherwise, two separate thresholds for “commodity derivatives” and “Other OTC derivative contracts” should be introduced.

5) Recognition of risk factors

The notional value does not appropriately take into account the risk of the derivative portfolio in question. Therefore and to be in line with the rules of CFTC, ESMA should also allow adjusting the relevant nominal exposure to certain risk factors reflecting the simplified risk profile of the type and the residual maturity of the derivative (e.g. 0.075 for FX derivatives with a residual maturity of over five years).[8]

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7 See CFTC / SEC, l.c., p. 584 et seq.

8 See CFTC / SEC, l.c., p. 583 and the respective table enumerating the risk factors: “For positions in swaps that are not subject to daily mark-to-market margining and are not cleared by a

6) Threshold calculation should exclude intra-group transactions

ESMA should clearly stipulate that intra-group transactions are not taken into account for the calculating of the clearing threshold. This would be in line with the EMIR rules which provide an exemption of intra-group transactions from the clearing obligation and from bilateral collateralisation. Furthermore, intra-group transactions do not result in a net position vis-a-vis external counterparties.

7) Notification of clearing threshold breach only to ESMA and the competent authorities

ESMA should not impose further disclosure or notification obligation on non-financial firms which go beyond the notification of the breach of the clearing threshold to ESMA and the respective national competent authorities (see Art. 10 para. 1 lit. a EMIR). It should be the task of ESMA or the competent authorities to implement and update a respective public register. Irrespective of this regulatory situation, counterparties are free to agree bilaterally to notify each other if they have breached the threshold.

II) Reporting Obligation (Annex V)

ESMA should take into consideration that non-financial companies have not implemented sophisticated reporting structures as regards their derivative transactions. It is also not appropriate to require all counterparties to report the market value of their exposure on a daily basis. So far the vast majority of non-financial companies collect such values only if required by their annual or quarterly reporting standards. The additional administrative burden would not adequately reflect the benefit of the daily valuation. Hence, reporting requirements for non-financial companies should be proportionate. Furthermore, regarding the transmission of data to the trade repositories it is vital to provide interfaces that allow a straight through processing of the information, as it works for example via SWIFT. Manual uploads or similar manual processes would incur unnecessary administrative costs and should be avoided.

1) Reporting start date

Regarding the entry into force of the reporting obligation, ESMA mentions the earlier of 1 July 2013, 60 days after the registration of a trade repository or 1 July 2015. Firstly, there is a lot of work to be done by ESMA and non-EU authorities to e.g. elaborate feasible, global solutions for the identification of the trades reported to the trade repositories. By now we are far away from practicable solutions (see below). To avoid an additive cost burden we also strongly oppose European interim solutions instead of an international agreement. It should be ensured that the processes which have to be implemented by market participants can rely on final rules. Secondly, non-financial companies have to comply for the first time ever with the demanding transaction reporting regime of EMIR. Given these circumstances and the fact that trade repositories need to be registered, it seems more appropriate to define a later starting date such as 1 January 2014 for a derivative for which a registered trade repository is available. Otherwise, the final starting date should be postponed to 1 January

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registered or exempt clearing agency or a derivatives clearing organization, potential outward exposure equals the total notional principal amount of those positions, multiplied by the following factors on a position-by-position basis reflecting the type of swap."

2016. Also, once a trade repository has been registered, a period of only 60 days seems not feasible and should be therefore extended to 6 months.

2) Daily reporting of market values

We are very concerned about the newly introduced proposal of ESMA to oblige market participants to report information of the market value of their contracts on a daily basis (see p. 49). This requirement would be a huge administrative burden for non-financial companies irrespective of their size.

For the following reasons we do not see that the reporting of the market value is justified:

- We strongly doubt that the obligation is in accordance with the reporting obligation as defined in Art. 9 para. 1 EMIR which states that the “details of any derivative contract they have concluded and any modification or termination of the contract” should be reported. A market value which is calculated and updated on a daily basis could logically not be a contract detail. Therefore, we do not think that the requirement to daily report the market value is covered by EMIR;

- Art. 11 para. 2 exempts non-financial companies from the obligation to mark-to-market the value of outstanding contracts. To force these companies to report their market value on a daily basis would obliterate this exemption and therefore contradicts EMIR. This issue was also addressed by ESMA in its spring discussion paper. On p. 52 ESMA already raises the question whether such a rule would be appropriate by explicitly referring to the counterparties which are obliged for the daily calculation only;

- In its impact study ESMA discusses pros and cons of the market value in the context of the calculation of the clearing threshold (p. 187). ESMA prefers the nominal value with the explanation that one disadvantage of the market-value-approach is that it is more complex to use for some companies. To introduce the daily market valuation for every company “through the backdoor” would contradict this analysis;

- We doubt that the aggregation of the market values will lead to a meaningful result as the methodology used by the market participants differs significantly (e.g. the assumptions regarding the respective yield curve).

Taking these arguments together, we strictly oppose the proposed reporting obligation as not being coherent with EMIR. At least non-financial companies not exceeding the clearing thresholds should be exempted from this obligation.

3) Delegation of the reporting obligation?

We advocate the possibility to delegate the reporting obligation which would provide companies the choice either to report for their own or to mandate their counterparties to report on their behalf. Delegation would also be an adequate mean to ensure that the reporting is processed without duplication.

The statements in the text regarding the delegation are confusing. While p. 44 sticks to the wording proposed in the spring discussion paper that the counterparty data are to be reported by each counterparty, Rec. 1 of the draft standards in Annex V states that the “a counterparty should be able to delegate the reporting to the other counterparty.” To avoid a misunderstanding, it should be clarified that delegation is possible without any limitation.

4) Reporting of intra-group transactions

Regarding intra-group transactions, ESMA should take into account that delegation of the reporting requirement to a third party (especially the financial counterparty) is not possible. Therefore we would propose a lean reporting requirement for intra-group derivatives of non-financials. The data which is to be delivered by the respective non-financial counterparty for intra-group transactions should be restricted to the requirements laid down in Art. 6 para. 4 lit. b EMIR: Type, underlying (i.e. hedged item), maturity, notional value, price and settlement date.

5) LEI / Product ID / Trade ID

We do not support the ideas of global identifiers for legal entities, products and trades in its entireness, as given further below. As a general comment, it will be very important that any identifying numbers, in particular regarding to trades, are available at any time, and at an acceptable cost to those that are not running trading operations as a main concern. Reporting companies should never have to wait for these identifiers in order to be able to fill in the report in due course. Last, not least, we oppose interim solutions as this could end up with numerous interim solutions under many different regulations.

a) Legal entity identifier (LEI)

While we support this proposal in general, we strongly suggest not requiring LEI for both sides of intragroup transactions, which will be reported by group treasury (itself presumably bearing a LEI). As the internal counterparties are not relevant for external market players, it should suffice to give their legal names to regulators instead of a LEI. This would significantly reduce effort and cost for non-financial companies.

Furthermore, in cases where a LEI is not available (yet), the alternatives should not be restricted on BIC and BEI (as indicated under ref. 264). Other appropriate codes, e.g. the EIC, should be permissible as well.

b) Product ID

We would support such an approach as long as it is limited to general categories which can be used for whole categories of derivatives. Example: for F/X derivatives, there could be one ID each for F/X forwards, F/X swaps, and F/X options. This would allow to quickly identifying the type of derivative without causing too much effort.

c) Trade ID and time stamp

We are strictly against these, as it would require either a central agent to generate such numbers for both counterparties, or a very specific set of rules so they could produce that number themselves (which would still not solve the problem of agreeing on a common trading time, though). The central agent solution would presumably be expensive and prone to time delays when a number is requested (needs to be provided real-time), which is not acceptable in daily practice. The second would require counterparties to implement such a routine into its own systems, which can be anything from technically impossible to highly complex and costly, depending on the system a corporate is running – this would be especially burdensome for smaller companies that often use a less sophisticated system environment for their treasury operations.

For the reasons given above, we suggest that ESMA is limiting the requirements for non-financial counterparties to the provision of LEI and product ID [as given under a) and b)]. Given the much lower frequency and number of transactions taken when compared to financial counterparties, a requirement to comply with c) as well would be highly disproportionate.

6) Reporting of collateral

In general the vast majority of non-financial companies do not collateralise their derivative exposure because the cash that has to be delivered would be no longer available for operative purposes and there is no need for collateralisation when the counterparties are creditworthy. Nevertheless, some non-financial companies are collateralising a part of their exposure on a discretionary basis. To report this collateralisation would increase the administrative burden for these companies inappropriately and decrease incentives for collateralisation. We therefore oppose this requirement.

Furthermore, while the exposure can be reported on a trade by trade basis this is of course not feasible for collateral as it is exchanged on the total net exposure basis with the respective counterparty. This means that – if at all – the reporting should not be done on a portfolio basis as proposed by ESMA but on a counterparty by counterparty basis.

7) Novation and clearing obligation status

ESMA should clarify that novation should only refer to the CCP clearing. ESMA should also put straight that the reporting whether the counterparty is above the clearing threshold should be restricted to the point in time the derivative is entered into. As this “status” may change over time this would otherwise mean that the data in question should be updated for the whole exposure which would be inappropriately cost intensive.

8) Avoidance of double reporting

Double reporting, i.e. reporting of the same transactions in different formats to different trade repositories should be avoided by all means. Therefore, we welcome ESMA’s call for international consistency (ref. 244) and format standardisation between EMIR and MiFID / MiFIR (ref. 253 to 255).

ESMA also intends to ensure compatibility with other "high level principles at international level" and format standardisation between EMIR and MiFID / MiFIR, but it's really the details (standards, codes etc) that will create burdensome duplication of work. So a format standardisation, in particular also with the reporting obligation according to the U.S. Dodd-Frank-Act and REMIT, is important.

In respect of the transactions to be reported under REMIT (gas, power, transportations) we propose that ESMA accepts the definition of the transactions reporting requirements, in particular the formats, codes, frequency, defined by ACER and the EU Commission.

III) Transparency and data availability (p. 162 et seq.)

For confidentiality reasons, information disclosed to the public by a trade repository should be on an aggregated level and needs to be anonymous. Market participants should not be able to draw conclusions from the information publicly provided on the companies' risk-mitigating strategy or other specifics from strategic importance, neither directly nor indirectly. As Art. 2 of the proposed technical standards (p. 164) does not further specify on which aggregation level the open positions are to be published we would recommend to disclose only *the* aggregate amount of the type of instrument and do not require more granularity. We believe this is sufficiently informative for the public and ensures the counterparties' confidentiality.

IV) Risk mitigation for OTC derivative contracts not cleared by CCP

The risk mitigating techniques proposed by ESMA are very ambitious and very difficult to implement for non-financial companies. Especially for those companies it is very important to grant a phase-in-period which takes properly into account the limited capacities of non-financial companies to adopt the requirements.

1) Timely confirmation (Annex II, Art. 1 RM)

Although we appreciate that ESMA decided to extend the confirmation period in general to two days for non-financial companies not exceeding the clearing threshold we are of the opinion that this is still too ambitious.

While non-financial companies are in many cases able to confirm their trades quickly, the length of the confirmation process varies with the specifics of the transaction. The confirmation period also depends on the ability of the selling counterparty to facilitate the process and to pass on the terms of the respective derivative in due time to the buying counterparty (as a rule the non-financial company). E.g. it would be very difficult for the buy-side company to confirm a trade in two days when it takes the selling counterparty nearly two days to turn over the respective confirmation.

Furthermore, ESMA should provide clarity for the case that one of the counterparties does not comply with the required confirmation period and does not return the confirmation within the said deadline. As a result the other counterparty would not be able to comply with the requirement as well which would be nevertheless not its own fault. In addition, especially regarding risk-mitigating derivatives, which are in general customized and therefore base on much more "individual" contract specifics, the confirmation process takes more time compared to more standardised products.

As bespoke transactions are primarily used by non-financial counterparties, the confirmation period for these market participants should be extended to ***four business days*** after the execution.

Nevertheless, ESMA should also take into consideration that the confirmation of more complex transactions cannot be processed in the above mentioned time period [e.g. 'long confirmations'; additional (not prior mentioned) legal terms included in the confirmation; involvement of different departments within a company]. For these transactions the confirmation will take 5 to 10 business days without becoming undue. ESMA should therefore acknowledge a preliminary confirmation regarding the economic terms, which is often exchanged by the counterparties in order to value the derivative, as equivalent to the "full" confirmation.

2) Portfolio reconciliation (Annex II, Art. 2 RM)

The obligation to reconcile portfolios is an important risk management tool for counterparties engaging in derivative trading on a large scale. Especially for non-financial companies using derivatives almost exclusively for risk-mitigating purposes, it would be very burdensome to reconcile portfolios held with 10 or 15 banks even on a monthly basis. This would bind capacities disproportionally. A permanent reconciliation process is also not necessary when the confirmation process is adequately implemented and it implies significant investments in additional back office resources or the purchase of a costly technology. Even though a technology carries out the matching of portfolios, resources are required to analyse the results which often involve different areas of the counterparty (e.g. credit and market risk, back office, etc.). The non financial counterparties do not have dedicated teams like the financial counterparties have and would then need to employ additional resources, this just because of the time constraints due to the high frequency.

Therefore, we would like to propose that non-financial companies which have not exceeded the clearing threshold should be allowed to perform a portfolio reconciliation once a year (e.g. as it is already done in a similar way by the company's external auditor as part of the annual audit). This would be in line with the requirement in Art. 8 para. 1 lit. b EMIR which states that the formalised process in order to reconcile portfolios should be "robust, resilient and ***auditable***".

Furthermore, when reading the description of the requirements in Rec. 19 of Annex II it becomes obvious that the data expected for the reconciliation is only relevant for very standardized products. One escalation step of the dispute resolution process is to recalculate the valuation of the transactions, this based on independent market quotes, e.g. quotes published by the three main brokers present on the respective market. In the case of non standard products, standard quotes are simply not available. Therefore, the question is in that case which reference price should be relevant for the dispute resolution.

3) Portfolio compression (Annex II, Art. 3 RM)

Derivatives used by non-financial counterparties for hedging purposes are in general held until maturity or will be bilaterally adjusted in case the underlying business have changed (as mentioned above). As long as there is an underlying business, there is no reason for a portfolio compression which is processed to eliminate redundant contracts simply because in general there are no such contracts.

We welcome the approach of ESMA not to set a hard obligation for portfolio compression but to provide to the counterparties the option to assess the possibility to conduct a portfolio compression. The reasons for not conducting a portfolio compression should neither be actively notified nor be agreed with the national competent authorities. It would be sufficient if the counterparties can explain the reasons on request of the regulators. Nevertheless, the process to explain the reasons for the deviation should be kept as lean as possible especially for portfolios of non-financial companies including almost exclusively risk-mitigating derivatives.

ESMA should also make clear that a portfolio compression only makes sense if the counterparties can net opposite transactions in a sufficient number in the same asset class, because the aim of this compression is to close out opposite positions.

4) Dispute resolution (Annex II, Art. 4 RM)

In general, we are very satisfied with the dispute resolution mechanism provided by existing contract standardisation, e.g. German Master Agreements or ISDA Master Agreements. These master agreements adequately reflect the need for companies to maintain detailed procedures for investigating, recording and resolving disputes.

Although we agree that the most rapid collateral dispute resolution possible should apply, but in practice, mandated resolution on a 5 days timeframe is infeasible. In accordance with the existing 1992 ISDA Master Agreement provisions we would suggest a 30 days timeframe which is very strict but feasible. Some reasons for allowing more time to resolve a dispute include:

- The portfolio reconciliation results must be analyzed to determine the root causes of the dispute. This can take time to accomplish. If the process is conducted across different time zones, all aspects of the resolution process will take longer on top.

- Some disputes require trader-to-trader discussion to resolve. Others may need to be escalated to senior management for further discussion.

- A small number of disputes prove to be intractable throughout the foregoing process and must be resolved via an independent reference process such as a market poll or another agreed upon dispute resolution methodology. All polling processes require time to prepare, execute and then assess results. Depending on the product involved, substantial effort may be required to price transactions. The time to execute a poll for a complex structured derivative may be measured in hours or even days as time is required to build and populate a valuation model.

Third party arbitration and/or market polling are not the only sufficient options to settle collateral disputes. Parties to a collateral dispute may view third party arbitration as an option that is always available to two consenting firms, but only to be used after exhausting all other potential remedies. But third party arbitration is difficult as it is not easy to find adequate arbitrators who are able to accurately price bespoke transactions that are generally used for risk-mitigating purposes.

We would suggest clarifying that the dispute reporting obligation refers only to disputes regarding OTC derivative transactions between financial counterparties and not between a financial counterparty and a non-financial counterparty as the non-financial counterparties are in general not systemically relevant. Notwithstanding the aforementioned, if disputes between financial counterparties and non-financial counterparties shall be reported by the financial counterparty we would suggest that the financial counterparty has to consult the non-financial counterparty before providing a dispute resolution report to the competent authority. Finally we would suggest extending the timeframe for the reporting to 30 days or more outstanding so long as they are intended to be reported on a) monthly frequency, b) at the portfolio (and not the trade) level and c) reflect the cumulative age of the dispute (meaning the collateral dispute continues to age if the dispute swings from one disputing party to the other).

5) Intra-group exemptions (Annex II, Art. 7 RM and 8 RM)

Intragroup transactions do not constitute counterparty risk towards third parties. Therefore, we propose to keep the notification process as lean as possible. To simplify this process the notification should be done once for the entire corporate group, as this would avoid multiple notification proceedings.

In addition, especially the obligation to provide a legal opinion is not necessary and extremely costly (Art. 7 RM para. 3). To carefully analyse the legal opinions for many subsidiaries would also overstretch capacities of supervisory authorities in the notification process. Therefore, it should be left to the own assessment of the company to prove that it complies with the respective requirements which are the prerequisite to qualify for the exemption.

Furthermore, it is very likely that all non-financial companies exceeding the clearing threshold will apply for the group exemption. Therefore, we expect a vast number of notifications which will take time for the supervisory authorities to be thoroughly analysed. For reasons of legal certainty it is very important that ESMA clarifies that intragroup transactions are not obliged to be bilaterally collateralised until the notification process is finalised. Otherwise this would lead to the paradox situation that an intragroup transaction has to be collateralised until the exemption becomes valid.

V) Clearing obligation procedure

In assessing the degree of standardisation as a criterion for the clearing eligibility, ESMA should not refer solely to contract standardisation. ESMA should also consider that many contracts, especially those which are entered in a risk-mitigating purpose, base on standardised contracts (e.g. German Master Agreements, ISDA Master Agreements etc.). Although the contract details are standardised, this does not mean that the economic terms are standardised as well. On the contrary, these terms differ especially for risk-mitigating derivatives in a wide range because standardised terms are not suitable to appropriately reflect the specific risk-mitigating needs of the underlying business. This should be taken into account by ESMA.

VI) Collateral requirements

There is no doubt that bank guarantees are a very important alternative to cash collateral especially for non-financial companies, having no access to central bank money.

Nevertheless, we are concerned that the option to provide bank guarantees is diluted by the requirement to back these guarantees with collateral and that such collateral can be liquefied on a same-day basis [(Annex III, Art. 1 COL para. 3 lit. c (viii)]. The additional costs occurring to the bank for the collateralisation would be passed on to their clients and disproportionally increase the prices of bank guarantees and would also decrease incentives for central clearing if the non-financial company is not obliged to clear. These costs are not justified for the following reasons: Firstly, the requirement to back the guarantee with collateral is superfluous because the risk arising from the provision of bank guarantees is mitigated sufficiently by the other requirements for bank guarantees also proposed by ESMA. Secondly, the obligation to fully back the guarantee lacks economic rationale: This would only be justifiable for the case that the whole amount of all respective bank guarantees provided by one bank is drawn from all clients at the same time. Without doubt, this is a very unlikely assumption. For this reason a partial collateral backing would be justified, but not a full collateralisation. Thirdly, for coherence reasons we would suggest to realign the collateral obligation with the Basel III / CRR rules concerning the liquidity coverage ratio which requires a **10 per cent liquidity coverage** for outstanding credit lines for non-financial companies.

Furthermore, we are concerned that the term “entity which provides essential services to the CCP” should not be interpreted too restrictive [(Annex III, Art. 1 COL para. 3 lit. c (vi)] as these entities are not allowed to provide a bank guarantee. It should be ensured that the number of banks that are allowed to provide a bank guarantee for derivatives of non-financial companies would not be inappropriately limited.

Annex

Examples for common risk management practices in non-financial companies

The examples below should describe the risk-management via macro hedging structures in a non-financial group. As a rule it is common practice that the group-wide risk management is centralized on headquarter level or a legal entity to provide internal derivatives for each operative group entity. The risks of the whole group are mitigated by external derivatives entered into between the centralised entity and a financial counterparty.

1) Foreign exchange

The first example refers to the management of currency risks and is intended to show the following:

a) Because of the possibility to ***net*** the exposures of every single group entity macro hedging is a very cost efficient risk management strategy which also reduces counterparty risk significantly;

b) Because of unexpected changes adoptions on the planned exposures may become necessary. Against the background of cost-efficiency the company has to decide whether the contract is terminated or whether the open position is closed with a derivative of another bank. In the latter case the values of both derivatives compensating each other and the position becomes risk neutral.

Ad a) Figures in the table below show each single exposure in USD (both booked invoices and planned future invoices/future cash flows) which is captured individually for each legal entity (each group member). To avoid losses accruing from the underlying fluctuations of the EUR / USD price these exposures are hedged. As described above the exposures on legal entity level are hedged both for long and short positions by internal derivatives provided by the central entity (see figures in the example below listed under “Details”). Externally, only the net position for the whole group is hedged by the central entity with derivatives concluded with financial counterparties. In the example below, the net hedging position for the whole group amounts to 100.6 USD which is really low compared with the positions that would be otherwise – without macro hedging – hedged on every entity level. Therefore, costs can be saved and counterparty risk can be reduced.

Ad b) Although it is tried to match the net underlying as close as possible, there are often certain pre-defined thresholds which allow to not adapt the external position for smaller changes (in the example, external hedges of 100.6 USD are executed, whereas the net exposure on group-level is 104.0 USD). For future cash flows the external position will be adapted only if material changes e.g. in general business planning or M&A occur. In case the planned exposure decreases and the external position is adapted accordingly, this may lead to economically closed positions. However, when looking at gross notional values, these economically closed positions still may occur and be “counted” as separate positions. This is the reason why corporates need a *net* approach per derivative class.

Description	**USD**
Exposure (in EUR)	**82.5**
Exposure (in USD)	**104.0**
Benchmark Hedge (in USD)	**100.6**
Deviation in %	**-3.3%**
Details	
Legal Entity 1	235.8
Legal Entity 2	29.4
Legal Entity 3	-5.5
Legal Entity 4	-1.3
Legal Entity 5	0.0
Legal Entity 6	-3.6
Legal Entity 7	0.3
Legal Entity 8	4.4
Legal Entity 9	-0.1
Legal Entity 10	0.1
Legal Entity 11	-155.5

2) Interest Rates

Another example for macro hedging is the management of interest risks which is commonly steered on a target duration based concept. Not every swap can be designated to hedge accounting (e.g. not payer swaps to increase duration while having no floating bonds or CP outstanding for designation).

Due to changes in the underlying net (!) debt position, swaps will be concluded to bring the duration on target again. Possible resulting economically closed positions may nevertheless still be "counted" separately when looking at gross notional volumes of our derivatives. Therefore, we strongly urge ESMA to use ***net*** positions in each class of derivatives.