The European Association of Corporate Treasurers

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Comments in response to ESMA consultation paper: Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories

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The European Association of Corporate Treasurers (EACT)

The EACT is a grouping of 20 national associations representing treasury and finance professionals in 17 countries of the European Union. We bring together about 8,100 members employed within 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.

Our contact details are provided on the final page of this document.

1 – Introductory comment

The EACT welcomes the work done by ESMA to develop the draft technical standards covered by this consultation paper. In the aim of providing the most constructive support to ESMA we are limiting our comments to the areas of most concern in the drafting. In all cases the views we express are done so from the position of non-financial counterparties, in other words the real economy end-users of the financial system.

It is also important to underline that our comments reflect the perspective of the classic role of the corporate treasurer, which is to use financial instruments such as derivatives to mitigate rather than to take on risk.

Our comments on ESMA's drafting can be grouped under the following headings:

- definition of hedging;
- clearing thresholds;
- administration requirements – risk mitigation techniques; and
- reporting to trade repositories.

2 – Definition of hedging

ESMA's approach

Annex II, Chapter VII, Article 1:

We support the broad definition proposed by ESMA for contracts that are objectively measurable as reducing risks. We are however concerned that the para 1a inclusion of the words "in the ordinary course of its business" will have adverse consequences for risk management by non-financial counterparties. The words can be interpreted as introducing restrictions on the use of derivatives for risk mitigation entirely appropriate for such counterparties. The most obvious example of this is when risks associated with planned acquisitions are prudently hedged.

We also feel that the explicit exclusion of stock option hedging is an error on the part of ESMA. To suggest as ESMA does (para 60 of the consultation paper) that stock option plans cannot be considered directly related to the commercial or treasury-financing activities is at odds with all accepted views of good practice in this area.

EACT's proposal

2.1 – deletion of the reference to "in the ordinary course of its business" in paragraph 1a

2.2 – explicit clarification that contracts associated with hedging of stock option plans qualify as objectively measurable as reducing risks

3 – Clearing thresholds

ESMA's approach

Annex II, Chapter VII, Article 2:

We are content with the notional values proposed. However we feel that:

- explicit clarification is needed that intra-group transactions do not count against the threshold;
- clarification is also needed that when an existing contract is offset by another contract intended to neutralise the earlier with the least possible basis risk, the net rather than gross notional values should be used for the purposes of calculating whether the clearing threshold has been breached. Such situations arise routinely as non-financial companies in the ordinary course of business mitigate a risk that at a later stage is recognised as no longer likely to arise; and
- the clearing obligation should not apply to all OTC derivatives as a result of a clearing threshold breach in one specific asset class. We recommend that only OTC derivatives in the same asset class as the specific clearing threshold that has been breached are subject to the clearing obligation.

We are also concerned that a weakness in ESMA's approach is an absence of a clear commitment to align its rules as far as possible with those developed in the United States and by BCBS/IOSCO (through appropriate negotiation). In this context we welcome the recently announced extension by the European Commission of the deadline for draft regulatory technical standards.

EACT's proposal

3.1 – clarification that intra-group transactions do not count against the threshold, that net rather than gross notional values can be used in the circumstances described above and that breach in one specific asset class does not trigger the clearing obligation for all asset classes

3.2 – further work by ESMA to ensure the differences between EU, US and BCBS/IOSCO standards are minimised

4 – Administration requirements – risk mitigation techniques

ESMA's approach

Annex II, Chapter VIII

ESMA's drafting (paras 69 – 115) shows little sensitivity to the fundamental differences in structure and resource between financial and non-financial entities; it also does not recognise that the ability of large multinational companies to deal with the new regulatory framework is substantially greater than that of SMEs. It is the latter group of companies – vital to stability and growth in the European Union – that will tend not to be participating in the current consultation and yet will be materially impacted by the detailed requirements ESMA is establishing. Even the very largest companies will face additional costs and skill requirements to cope with the new framework. We note with irony that the companies we are describing played no part in the creation of global financial systemic risk and continue to have no responsibility for it.

We consider there is a potential contradiction between ESMA's proposals and the EMIR wording in terms of the notification requirements for intra-group transactions.

EACT's proposal

4.1 – timescales for deal confirmations (Article 1) should be extended to two working days for electronically executed or processed transactions and five working days for all others

4.2 – portfolio reconciliation (Article 2) for non-financial counterparties should be required only annually

4.3 – there should be an exemption from the portfolio reconciliation and portfolio compression requirements for intra-group transactions

4.4 – the apparent contradiction – between EMIR (Article 4, para 2a), requiring pre-notification of the intention to use the intra-group exemption and the ESMA drafting (Article 7, para 4), allowing for notification within 14 days of utilising the exemption – should be resolved largely in line with ESMA's drafting: on this basis the draft technical standards should allow for notification either prior to or no later than 30 days after the event.

5 – Reporting to trade repositories

ESMA's approach

Annex V, Article 3

ESMA establishes a daily mark-to-market reporting requirement for all contracts. This does not appear to be consistent with the wording of EMIR Article 9, para 1. We cannot see any regulatory justification for such a requirement. Even more importantly such reporting would create an impossible administrative burden on all companies but especially SMEs.

EACT's proposal

5.1 – deletion of this reporting requirement

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Registered Office:	20 rue d'ATHENES 75442 PARIS Cedex 09
EACT Chairman:	Richard Raeburn chairman@eact.eu +44 20 8693 7133
Website:	www.eact.eu