

European Securities and Markets Authority
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Dear Sirs

RE: ESMA Discussion Paper “Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories” of 16 February, 2012 – ESMA/2012/95

We, the Institut der Wirtschaftsprüfer in Deutschland e.V. [Institute of Public Auditors in Germany, Incorporated Association (IDW)], would like to thank you for the opportunity to comment on the ESMA's Discussion Paper. The IDW is a private organisation representing approximately 86 % of all German public auditors. In the following, we focus our comments on questions related to OTC derivative contracts used by non-financial counterparties.

Q2: In your view, how should ESMA specify cases where it is necessary or appropriate to prevent the evasion of any provision of EMIR for contracts entered into between counterparties located in a third country?

In general, OTC derivative contracts entered into with a counterparty located outside the EU should not be excluded from the scope of EMIR. However, for intra-group OTC derivative contracts where the other counterparty is located in a third country with an EMIR-equivalent regulation (especially Non-EU-G20-countries) an exemption shall be considered.

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB CPA;
Manfred Hamann, RA

Q10: In your view, does the above definition appropriately capture the derivative contracts that are objectively measurable as reducing risk directly related to the commercial or treasury financing activity?

We would firstly like to emphasise that we agree with the approach stated in paragraph 27 of the Discussion Paper whereby both OTC derivative contracts that protect non-financial counterparties against risks directly related to their commercial and treasury financing activities (hereinafter: risk-reducing) as well as those that do not protect against such risk but do not exceed a clearing threshold are not subject to the clearing obligation. We agree with the approach that the application of hedge accounting under endorsed IFRS (IAS 39 or the forthcoming IFRS 9) is in itself sufficient evidence that OTC derivatives are deemed to be objectively measurable as reducing risks directly related to the commercial or treasury financing activity. The same should be considered for OTC derivatives for which hedge accounting is applicable but which have not been designated according to IAS 39.88(a). We recognise this approach as the most cost-efficient way to identify risk-reducing OTC derivatives. Furthermore, it should be considered extending this accounting-based approach on equivalent accounting requirements according to EU-Member States' local GAAP and US GAAP.

However, since not all risk-reducing activities can be covered by hedge accounting additional criteria are required. We welcome the intention to define those criteria as stated in paragraph 29. Nevertheless, we would like to propose to precise the definition of the scope with regard to the following matters:

- Starting point should not be the individual OTC derivative but rather whether it is part of a portfolio which is managed according to a risk-reducing *strategy* being part of a documented risk management. This would comprise also OTC derivatives that individually are not risk-reducing but are within a portfolio-perspective.
- We understand that in lit. a all risks relating to commercial activities of a non-financial counterparty are covered. This includes, but is not limited to the risk-factors addressed in lit. b. A reader might not be able to understand the purpose of lit. b. In this respect, it should either be specified or deleted. In our opinion, a limitation to the risks resulting from a change in interest, inflation or foreign exchange rates is not appropriate.

Paragraph 27 of the Discussion Paper states that “at the point where the clearing threshold would be exceeded, the clearing obligation would apply to all OTC derivative contracts the non-financial counterparty will enter into after the time

that the firm has exceeded the threshold.” In our view, this extension of the clearing obligation to risk-reducing derivatives does not comply with the objectives of EMIR. If risk-reducing derivatives are considered as no threat to the stability of the financial markets – because they balance financial risks inherent in the commercial and financing operations of a non-financial entity – this characteristic remains whether the volume of trading derivatives exceeds a threshold or not. The proposed rule, however, has more the character of a penalty for exceeding the trading threshold than that of risk mitigating character. We therefore recommend applying the clearing obligation only to those trading derivatives that exceed the specified threshold.

Q11: In your view, do the above considerations allow an appropriate setting of the clearing threshold or should other criteria be considered? In particular, do you agree that the broad definition of the activity directly reducing commercial risks or treasury financing activity balances a clearing threshold set at a low level?

For the level at which the clearing threshold should be set it is important which timeframe is allowed for exceeding the threshold. Often derivative contracts have to be regarded as freestanding (and therefore “trading”) if the underlying they were hedging disappears or changes. This can especially happen in the case of anticipated transactions. Since it may take several days to settle or balance the freestanding derivative contract the timeframe should take account of this fact. For setting the level of the clearing threshold it also important to which extent offsetting is permitted.

ESMA suggests referring to the notional value of OTC derivative contracts for the purpose of setting the clearing threshold. It should be clarified whether short and long positions within each class of derivatives have to be deducted from each other or have to be added in absolute terms. In any case, offsetting across different classes of derivatives shall not be permitted. Therefore, only one total global threshold for all (classes of) derivatives seems to be advisable under the assumption that, after triggering the clearing obligation, only non-risk-reducing OTC derivatives have to be cleared.

Setting a double clearing threshold at the level of the legal entity and of the group would lead to unnecessary administrative burdens. The situation where the first entities to enter into OTC derivative transactions could consume the full threshold to the detriment of other participants will be prevented by group guidelines on contracting derivatives. We therefore recommend applying the meas-

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urement at group level only. However, setting additional thresholds for a subgroup of legal entities under a joint liability could be considered.

Other Remarks

One possibility worthy of consideration is the role the financial statements auditor of the non-financial counterparty plays or could potentially play in assessing an entity's compliance with the provisions of EMIR, including the accuracy of the distinction between OTC derivative contracts being used for risk-reducing purposes and OTC derivative contracts being used for trading purposes. Obtaining sufficient and appropriate audit evidence as required by the standards published by the International Federation of Accountants (IFAC) involves the auditor in the assessment of the risk management and the internal control system. We therefore recommend ESMA considering and specifying the role of the counterparty's statutory auditor.

Furthermore, we are concerned about the fact that several practical issues which, from our experience, can be commonly found at non-financial counterparties, have not been addressed by the Discussion Paper. These relate to

- derivatives being contracted by a captive which is part of a group of a non-financial counterparty in order to reduce commercial or treasury financing risk of the non-financial group entities.
- derivatives contracted by investment management companies (being financial counterparties) in order to reduce risks of the pension assets of a non-financial counterparty (otherwise there would be a liquidity burden from collateral management of the pension fund which does not apply to pension assets directly held by the non-financial group).

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

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Chief Executive Officer

Norbert Breker
Technical Director
Accounting and Auditing